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# ECONOMIC PROBLEMS OF TO-DAY

BY

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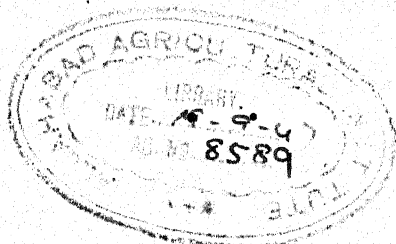
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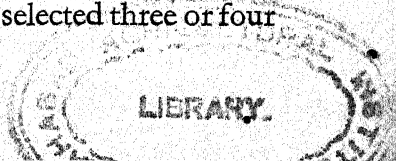
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## PREFACE

THIS book is written primarily not for the student of economics, but for those other students who, while preparing to devote their lives to work in other fields, would yet like to have some knowledge of the economic problems which loom so large in contemporary discussion, and on which as citizens they will be called upon to vote. It is accordingly essentially an introduction, which makes no claim to exhaustive treatment of the issues with which it deals, but seeks rather to avoid the mass of cumbrous detail in search of the underlying principles at stake.

At the same time I hope that the book may prove of some use to the ordinary reader perplexed by the heated propaganda thrown at him from all sides. Sooner or later, at work and at the polls, every one of us is called upon to pass judgment on these issues, so as to shape and reshape the social conditions in which we live. To fail to understand them is to pass the initiative into the hands of groups whose actions may change the whole pattern of our lives. Let the fate of Germany be a warning to any who would leave it to "politicians" to settle these matters for him.

At the end of each chapter is a short list of books for further reading. I have not burdened the reader with a long list which would leave him uncertain where to start, but have merely selected three or four



of the simplest. On some subjects, e.g., foreign experiments, it has not been possible to select a book specially written for beginners, but no book in the list should prove too difficult after the student has mastered the relevant material in this book. There is also a list of questions for discussion. Some of the questions are so framed that a complete answer cannot always be given solely on the basis of the material in the text, but the book is intended to serve as an introduction to discussion between student and teacher, and it is hoped that the teacher will elaborate where necessary.

There is nothing new in the book. To give a full acknowledgment of all those to whom I am indebted would require a long list of the names of all those who through the ages have contributed to economic thought. My special debt is to my teachers, Professor Arnold Plant and Professor Lionel Robbins, who have taught me all the economics I know. They have both been good enough to read the manuscript, and have made very helpful criticisms. I am also indebted to several of my colleagues and to Miss E. E. Dessin, Headmistress of the High School, High Wycombe, who have read and criticized the manuscript in whole or in part, and to my friend, Dr. L. A. H. McShine, whose awkward questions in the role of "intelligent layman" have forced me to clarify many obscure passages. Mr. G. W. Morris, Headmaster of Colfe's Grammar School, suggested the book, and has watched over its preparation with helpful care. To all these the book owes any merits it may have; its faults are mine alone.

Acknowledgments are due to Lord Snell and the Editorial Board of *Economica* for permission

PREFACE

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to quote the extracts on pages 68 and 78 respectively.

W. A. L.

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## INTRODUCTION

WHAT do we expect an economic system to do? A good enough answer, perhaps, as a first approximation, is that we want it to make us as well off as possible; to use our resources as fully as possible, and to the best advantage. This in turn raises several issues. First, what shall we use our resources to produce? Having only a limited amount of time, land and capital we cannot produce everything we would like; who is to decide what shall be excluded and what produced? Secondly, how are we to ensure that the right things are produced in the right proportions as efficiently as possible? This is clearly a matter of the inducements which people are offered to produce the right things, so our third problem is to study the way in which what is produced is distributed, and the influence of this on efficiency. A special problem which arises in this connection is that of property; who should be in charge of it, and what should be done with the income it yields? Finally two problems which gravely trouble the modern world, international economic relations and unemployment, call for our attention. All these are the problems which every economic system has to solve, and if we wanted to classify economic systems it would have to be according to the solutions they adopt.

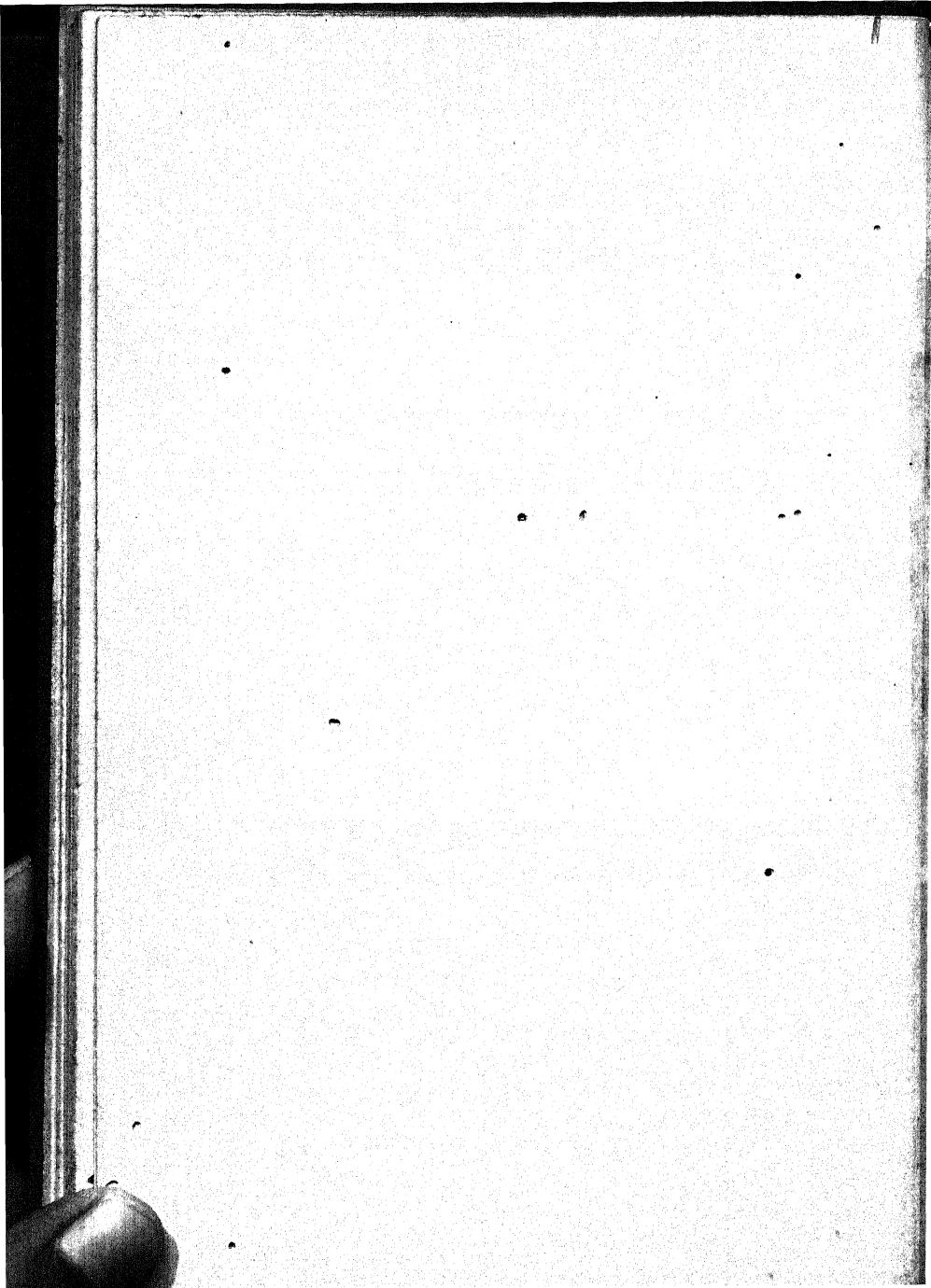
In this book it will be our business to examine the way in which various countries are tackling

these problems, though of course in such a small space we can only hope for a bird's-eye view, omitting the details. First, we shall begin by analysing in Part I the various solutions which might be adopted, in an attempt to discover their merits; and we shall do this mainly in the light of the way in which Great Britain has tackled them, since it is not easy to consider these problems so to speak *in vacuo*. After that we shall go on to see in Part II how the solutions which certain other countries have adopted are working out in practice.

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PART I

THE NATURE OF THE PROBLEMS, ILLUSTRATED FROM BRITISH EXPERIENCE



## CHAPTER I

### THE ALLOCATION OF RESOURCES

IF each one of us produced for himself all the things he used, the problem of deciding what should be produced would present little difficulty; each person would simply make what he wanted most. Until a few hundred years ago this was the system in vogue over practically the whole world, and indeed it is still to be found in very many places. The average Englishman of 600 years ago (and even later) grew his own wheat, baked his own bread, brewed his own beer, wove his own cloth and bought very little from other people. But the modern Englishman makes for himself very few of the things he uses, and indeed often does not himself use any of the things which he spends his working day in producing. We are all busily engaged in working for other people.

### THE DIVISION OF LABOUR

There is an excellent reason for this, and it is to be found in the old adage, "Jack of all trades is master of none." The world's work is done most efficiently when it is divided out among a number of people, each specializing on a different part of the job. Each man can then become an expert on his part, and as the whole job will be finished more

quickly, the division of labour makes it possible to produce much more than would be the case if we each tried to be self-sufficient. One of the most important clues to the rise in the standard of living during the last five hundred years is the increased specialization which has taken place.

Specialization means not only that work is divided between many people, but also that it is divided between different localities. The shirt an Englishman is wearing has probably been made of cotton grown in the United States of America or in Egypt; from overseas the cotton went to Lancashire, where it was turned into yarn by one set of people; the yarn into cloth by another set, and the cloth finished and dyed by still others. The actual job of making the shirt may have been done in some other part of the country. This is the territorial division of labour, industries being localized in different parts of the globe. This has tremendous advantages; conditions vary very much in the different parts of the world, and it is best that each country and each district should specialize in producing those commodities in which it has the greatest advantage. England could grow cotton, but only at such a disadvantage when compared with the other things that she can do, that it is best both for Englishmen and for the rest of the world that she should concentrate on those industrial products in connection with which she has the greatest advantages, and exchange them for cotton. Before he has reached the age of ten the average English child has used products from all over the world—rubber, tea, sugar, timber, steel, meat and scores of other things produced by people thousands of miles away, who

have never heard of his existence. Without international trade he would be a very poor fellow.

This serves only to show the immensity of the problem of deciding what is to be produced. How does the Australian farmer, producing for an English market, know whether to produce mutton or beef? If the world's resources are to be efficiently utilized, there must be some system of letting every one of its 2,000,000,000 people know just what is required of them—a gigantic task.

#### CONSUMERS' CHOICE

One solution would be just to let each person do what he liked best, or what he felt himself to be most capable of doing, or what he had always done in the past. But clearly this would be a bad system. Left to themselves the people living in coal-mining areas might be able to turn out several hundred million tons of coal every year, but if steamships prefer to burn oil, it may be better that some miners should turn their attention to producing other things which are more urgently required than coal. It is not the producer who must decide what should be produced, but the consumer. There is no point in producing things unless they are wanted, and so it must be left to the ultimate consumer to decide how the community's resources should be utilized. Many people think that the producer should take his instructions from some sort of Planning Board, but most people would agree that such a Board would only be functioning properly in so far as it turned out not what the factories and farmers said they would like to produce, but what the consumer

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really wanted. The final decision must rest with the consumer; he is sovereign.

### SOCIAL CONTROL

Now against this it is sometimes objected that complete freedom of choice is not in people's interest, for they often want things which are bad for them, and do not want the things which are good for them. There is of course a lot to be said for this point of view, and in every country of the world the state steps in to prevent people from having some things which they want, and to force them to have some other things whether they want them or not. For instance, in Great Britain people are not allowed to buy opium and other dangerous drugs without special permission, and one of the arguments sometimes advanced to support the heavy taxes on beer and other alcoholic drinks is that they discourage people from drinking. Again, every adult manual worker in this country is compelled, whether he likes it or not, to insure himself against unemployment, sickness and old age. Parents and guardians are compelled to spend some of their income in maintaining children at school up to a certain age, and every taxpayer is, in effect, compelled to buy a share in battleships and bombing planes even if he is a conscientious objector, and to contribute to the lighting and policing of the streets, to the maintenance of roads, and to other Government services, whether he makes use of them or not. Indeed, almost every law Parliament passes and every penny raised in taxation and spent by the Government or local authorities is designed to



prevent somebody from doing something he would like to do, or to force him to do something which he would not do if the law were not passed.

The point at issue is well illustrated by comparing the United States with Soviet Russia. In Russia the workers get only part of their income in the form of wages to spend as they please; a substantial part is kept by the government and spent in maintaining free social services and providing for the future. The American worker, on the other hand, gets much higher wages than the Russian worker, but very few free social services. Which is better off, the worker whose income is spent for him by the government, or the worker who does as he pleases?

There is a pitfall which we must avoid in considering this problem. Some people think that it is a good thing to have free schools, free hospitals, subsidized housing, and so on, if the state can "make the rich pay" by means of heavy taxation. But this is a confusion of different problems; the case for the redistribution of income through taxation is not the same as the case for free social services. Even if the state decides to take money from the rich and give it to the poor, the problem still remains whether it would be better to give this money to the poor in cash to spend as they please, or to use it to build hospitals and houses with low rentals. Suppose the Government decided to raise an extra ten million pounds by increasing the taxes on the rich, and it held a plebiscite to find out from the poor whether they would prefer to get this money in cash, or whether they would prefer additional schools and houses to be built with it, what would be the result of the plebiscite? And if substantial numbers voted

to have the money in cash, should the Government overrule them on the ground that they would not know how best to spend it?

The question is not easy to answer; indeed different answers would apply in different communities. In some parts of the world it would be dangerous to assume that every one is capable of looking after his own interests, and there would be a strong case for interference by a benevolent government—if such a thing can be found—to regulate production and consumption. In others people are more independent and progressive, and government interference correspondingly less necessary and beneficial. But even in the most progressive we cannot assume that everybody will conduct his affairs in the most sensible way; we know in fact that many people are apt to underestimate their future needs, and there may be a case for compelling them to insure against future contingencies. It may be that the American worker would be better off if, like the Russian or the English worker, he were compelled to use part of his income to insure himself against sickness—at any rate President Roosevelt seems to think so, for he has just started compulsory social insurance. Again, there seems to be an overwhelming case for forcing people to spend money on the education of their children, and to contribute to the lighting and policing of the streets, and some other government services. But is it not a serious problem to decide just how much interference with personal liberty can be tolerated? We can all see the need for some compulsion, and yet none of us would like to live in a state in which there was no freedom at all. This is the principal difference between the democratic

country and the dictatorship—a difference which is felt not only in the political but also in the economic field. Even in a democratic country like Great Britain the share which the government has in deciding what people shall consume is enormous; apart from laws compelling people to contribute to this or that, and other laws preventing them from having certain things they would like, there is the fact that central and local authorities between them take rather more than a quarter of the national income in taxation (between them they spend from £1,300,000,000 to £1,500,000,000 a year), and spend it as they think fit. In the totalitarian countries the proportion is much bigger and the consumer is allowed even less individual control over his own income. Perhaps most people would agree, in the democratic countries, at least, that the decision how to dispose of one's income is a sort of sacred right, and that it is only in exceptional circumstances that Members of Parliament should be allowed to interfere. After all, we may not know how to spend our money, but who does? And if we prefer being free to do things badly instead of being in our own interest compelled to do them properly by people of whose knowledge and good intentions we may be suspicious, what case is there for compulsion?

#### THE ROLE OF MONEY

Now if we grant, that with certain exceptions it is the individual consumer's personal tastes which should determine what is to be produced, we are left with the problem, how is he to let his wishes be known? Some people have suggested that this

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might be done by elections, as in the field of politics. Such people have not fully grasped the magnitude of the problem. For one thing, even in the political field elections enable the citizen to choose not so much what policy he prefers as what people he wishes to make certain decisions for him; it is in the plebiscite rather than in the election that he registers his choice of policy. But a much more important objection is that whereas in the political field the alternatives between which a choice has to be made are not very numerous, in the economic field there are millions of different alternatives between which to choose. Thus, if we consider only five commodities it might be possible to produce:

	<i>Tea</i> <i>tons</i>		<i>Coffee</i> <i>tons</i>		<i>Milk</i> <i>galls.</i>		<i>Houses</i> <i>No.</i>		<i>Shoes</i> <i>Doz. pairs</i>
	100	+	200	+	300	+	400	+	500
Or	100	+	200	+	400	+	400	+	450
Or	260	+	150	+	400	+	450	+	400

or any of many other different combinations. For the thousands of commodities which we are capable of producing there are millions of combinations in which they could be produced. What sort of election could decide this, and how often would it be held? We should need millions of candidates, each committed to a different combination.

In practice most countries do indeed solve this problem by a sort of plebiscite, but a very different sort from that which we find in the political field. It consists in giving every person his income in the form of money, and allowing him to vote by spending his money in the way which suits him best. The way in which he distributes it is the signal to pro-

ducers what to produce. If people are prepared to pay more for a commodity than it costs to produce, this is a sign that more of that commodity should be produced; if on the other hand they are not prepared to spend as much as the commodity costs, less of it ought to be produced. For what are "costs"? The cost of producing any commodity consists of the sums which have to be paid to workers, managers and property owners in order to secure the use of their resources. But what determines the size of these sums? This depends on what the workers and property owners could receive by using their resources to produce other commodities; and what they could receive depends on the value which the public places on those other commodities. *The cost of producing a commodity reflects therefore simply the value which the public places on the other commodities which might be produced in its stead.* If people are not prepared to pay for this commodity as much as it costs, this means that society as a whole places a higher value on the alternative commodities which can be produced. Thus the use of money is a sort of election in which people are voting every minute of the day. Moreover, it is an election in which the rights of the minority are expressly protected, for within the limits of his income any person can have just so much or so little of any commodity as he likes, provided he is willing to pay the cost of producing it.

#### "PRODUCTION FOR PROFIT"

Some people have objected to this system on the ground that it is production "for profit" and not

"for use." Stated in this way the objection is very misleading. In the first place, production is not governed by the level of profit any more than it is governed by the level of wages, for profit is the remuneration of those who manage undertakings or supply them with capital, just as wages are the remuneration of those who work in them. If a worker finds that he can earn higher wages as an electrician than as an agricultural labourer he will become an electrician, and if an entrepreneur (as the people who manage concerns are called) finds that he will earn higher profits in electricity than in agriculture he also will switch over; it is therefore inconsistent to condemn the fact that entrepreneurs seek the sources of highest reward unless we would also condemn the worker who does the same. Secondly, it is misleading to say that this is not production for use. For no one can earn any income—wages, profits, rents, interest—in this way unless he can persuade the public that his products are useful enough to be worth buying. Indeed, as we have seen, to produce the commodities which yield the highest wages and profits is to produce those which the consumer considers most useful.

Those who raise this objection have nevertheless got a point to make though they put it badly. They note, for instance, that it seems most profitable to produce vast luxury liners and hotels while millions of people live in slums, and private aeroplanes and super cars while many children have to wear ragged boots, and so on. The point is that this system of deciding what should be produced gives to the people who have most money to spend the largest say in determining the course of production. Put

it in this way: a man with an income of £1,000 a year has ten times as many votes as a man with £100 a year, and this is why the decisions of the rich are able to overrule the decisions of the poor. But what is really being objected to here is the present income and property structure. If income were distributed according to some plan considered just, any other system, save that of letting consumers spend their money as they like, would be arbitrary. It is not therefore the system of using money which is at fault, but the present distribution of income, and if we wish to put matters right it would be better to attack the real source of trouble rather than to tinker about with consumers' choice. The problem of the distribution of income is, however, bound up with the next one on our list, namely, how to persuade people to produce the right things, and we must consider them together.

### INCENTIVES

Granted that society has evolved a system for discovering what ought to be produced, the next problem is, how to get each person to produce the right thing? One solution would be for a central authority to tell each person what he should do and compel him to do it. Such conscription is the logical background to most of the schemes for "planning" which have been put forward from time to time. As we shall see in the Appendix to this chapter, in times of severe emergency, such as war, most countries resort to some system of this kind, but no democratic people has adopted it as a peace-time device. It is, however, to be found to some extent

in Germany and Soviet Russia, though when we come to consider its operation in those two countries we shall see that in the latter planning is being modified and losing its importance because of its disadvantages. For it is in many ways inferior to the alternative solution to this problem, viz., to offer people incentives to produce the right things in the right proportions.

How do we know what is the right niche for each person in the economic system? From the point of view of the consumer, the right niche is that one in which the worker's services are most valuable, and would therefore command the highest price. The right job is not necessarily the one he can do best; a man might be a first-class dustman but only a third-rate electrician, yet it may be better from the community's point of view that he work as an electrician if the need for additional electrical work is greater than the need for additional dustmen. Moreover, the right job from this point of view is not necessarily the one he would best like to do; this is why it is better not to compel him to do it, but merely to offer him incentives to do it.

Now every modern community has found that the best incentive for this purpose is to let the remuneration attached to each job vary according to the value which society places upon it, and to encourage each person to gravitate towards the occupation in which he can secure the highest earnings. This system of remuneration is very different from that which has always been dear to religious sects, viz., to give everybody the same income, or incomes which vary according to need without reference to the work they do. It is indeed



a makeshift. If people loved their neighbours as themselves, such incentives would not be necessary to get them to work hard or to do the right work; we would all willingly do whatever was asked of us, however unpleasant it might be. But unfortunately men do not love their neighbours as themselves; if earnings were completely divorced from work a very large number of people would slack off, and even of those who continued to work hard many would do just what they liked best, irrespective of its social value. Not everybody would behave in this way. Some people are very fond of their jobs, and no matter what the remuneration might be, would take pleasure in giving their best service—teachers, musicians, woodworkers, doctors and other skilled people are renowned for their selfless devotion to their work. But in the modern world few jobs are so fascinating as to be capable of stimulating such devotion; most work is a drudgery to be performed only as a means of earning a living. Similarly many people are very public spirited, and would do whatever work was assigned to them; but most of us have our own preferences, and unless special incentives were offered, would do the work which pleased us best rather than that which society valued most highly. It may be that with further education people might be made less self-centred, and might become more willing to do whatever was best for the community, irrespective of reward; there is indeed a good deal to be said for trying to persuade people to adopt this attitude, but until it is more widely adopted, we cannot dispense with rewards as incentives to labour of the right kinds. It is true, too, that non-monetary

incentives have a useful part to play; for instance in Russia public distinctions (e.g. the Order of Lenin) are conferred on exceptionally good workers in order to encourage workers to give of their best. But even in Russia non-monetary incentives have not proved sufficient, and it is for this reason that the Communist régime, which began its existence with a strong bias towards equality of income, is now one of the most ardent supporters of payment by results. The principle that people's earnings should vary according to the quantity and quality of the work they do has nothing more lofty to commend it than the fact that, given the frailty of mankind, society knows no better system of securing that the right things be produced abundantly.

A good illustration of this principle is furnished by the question whether entrepreneurs (i.e. the people responsible for organizing production) should be paid fixed salaries, or whether their earnings should depend on their capacity to please the public, as reflected in the profits of their firms. Some people would like to see industry run entirely by public officials drawing fixed salaries. (Now this is not the same as the question whether property should be nationalized or not; even if property is nationalized, as in Russia, the state still has to decide on what basis to remunerate its entrepreneurs.) In Great Britain the earnings of most entrepreneurs depend mainly upon their capacity to please the consumer. People who estimate demand correctly, and provide for it efficiently, make high profits, while those who estimate wrongly or are otherwise inefficient make losses. Clearly there is an enormous advantage there over the system of paying entrepreneurs fixed salaries,

independently of their results. The greatest possible initiative is secured; entrepreneurs are always on the lookout for new inventions, new ways of reducing costs and new ways of improving the quality of the service offered to the consumer. At its best (we shall discuss its shortcomings in a moment), competition between them secures that there will be the best possible utilization of resources, because those who rest on their oars will find themselves drifting over the weir.

With public officials drawing fixed salaries we cannot always be sure of securing this initiative; their incomes do not depend directly on the results, and therefore they are likely to be more leisurely and slower to respond to changes in consumers' demands and to new technical discoveries. Moreover, since losses fall not on them but on the public, and since they are violently abused if they make unsuccessful experiments, they are often loath to try out new ideas. Few great industrial advances would be made unless entrepreneurs were free, at their own risk to take chances with new methods and new products. In Soviet Russia, where there are proportionately more public officials responsible for industry than in any other part of the world, lack of initiative has been a great problem; and after experimenting with such extreme solutions as shooting officials suspected of resting on their oars, or banishing them to Siberia, the government is now increasingly paying its entrepreneurs by results and shifting them about according to the profitability of their enterprises, just like the entrepreneurs in countries where property has not been nationalized.

## DISADVANTAGES OF MONETARY INCENTIVES

Now no one believes that to pay people according to the value of their work is a perfect system. It has indeed most serious disadvantages. It is tolerated simply because nothing better has so far been devised; and as far as possible, attempts are made to mitigate its disadvantages.

(1) *Acquisitiveness*. "Money is the root of all evil." Under this system life becomes more obviously than ever a struggle in which each is trying to do the best he can for himself, whatever may happen to the rest. There is thus a danger that men of weak character may be infected by an acquisitive spirit, which leads them to act without charity to their neighbours, and even dishonestly. Religious and moral instruction—indeed most education—seeks to help people to overcome this temptation, but there are also other forces which prevent a competitive system from degenerating into a scramble. To some extent the system provides its own checks on dishonest dealing. "Honesty is the best policy"; in the long run it is not the baker who gives short weight or the butcher who sells bad meat that prospers. The more competition there is between sellers, the greater is the chance that the public will not be cheated. In other cases it is left to professional associations, like those of the doctors and the department stores, to lay down standards of conduct for their members in order to maintain the reputation of their trade. Man's predatory instincts are in these and other ways subjected to continuous educational influences which control them in favour of higher social codes. The state too can and does help in this

field. Thus there are laws regulating the quality of food offered for sale, and inspectors paid to examine weights and measures; and in those cases where other checks are insufficient to prevent dishonesty, it can take over the service itself, fixing the earnings of its employees so as to reduce the incentive to cheat—this is why we do not let judges and policemen work on a commission basis, while we insist on subjecting most other persons to the stimulus of payment by results.

(2) *Monopoly*. A much more serious disadvantage is the fact that to pay people according to the value of the commodity they produce gives them an interest in keeping the price of that commodity high. Now the price and value of a commodity depend on how scarce it is—we will not pay much for things which are abundant; hence the interest of every producer is that his product should be scarce, while the interest of society is that all things should be abundant. The results have sometimes seemed paradoxical; the bigger the harvest, the poorer the farmer may become; the more capable the machine, the smaller the earnings of the skilled craftsman; the more doctors there are in the community, the less each of them earns. We are all, as it were, "riding on the backs" of our fellows, exacting tribute because the resources we command are scarce, and so soon as they grow rich in the things we have to offer, we lose our special advantage over them, and our income declines. This is by no means an ideal way of running society; but so long as human-beings do not respond adequately to other incentives, we are forced to pay people according to the scarcity of the services they offer.

The natural consequence is that each person has an incentive to make the goods he supplies as scarce as possible. History tells many tales of men getting rid of their rivals in underhand ways, of sellers who disappeared, of inventions bought up and suppressed, or machines broken by riotous craftsmen whom they had displaced. More important to-day perhaps are the steps taken by sectional groups to limit their output, partly by agreement among existing producers, and partly by trying to keep out potential new competitors. Entrepreneurs enter into trusts, cartels, associations and other agreements for restricting output. Workers use their trade unions to limit the supply of people trained in their particular craft, by such devices as limiting apprenticeship; and just as the employer's association tries to stamp out competition, so the union fights the "blackleg" (a person who accepts work during a strike), and opposes "dilution" (the employment of workers who have not had the long training prescribed by the union). Such attempts to preserve scarcity for selfish ends often assume curious disguises, and are at their worst when they can be given a religious, racial or other significance. Thus men impose restrictions on the employment of women no less to preserve their earnings than to preserve their pride in their own sex; and restrictions on Jews, Negroes, Catholics, foreigners and other groups are nearly always based as much on the desire to secure monopolistic privileges as on group prejudice.

Now the existence of monopolies preserving scarcity is one of the major causes of the inequality of incomes, since it usually those in the higher

income groups who are most successful in maintaining monopolistic restrictions. For this reason the man in the street was always bitterly hostile to monopolies of all kinds, and anxious to destroy them. Unfortunately in recent years this hostility has tended to diminish, as men have been taught to believe that monopoly confers technical advantages which make its emergence inevitable. Fortunately this notion is almost entirely false. It is true that in a few cases if the product is to be made most cheaply the firm must be so large that there is room for very few in the same market; the provision of roads, and such public utilities as railways, gas, water and electricity are sometimes mentioned as cases of this type, and where this is so there is a strong case for having public officials to do the job, or if it is done by private individuals, subjecting them to close restrictions to prevent the abuse of monopoly power. But such cases are not really very numerous in comparison with the cases in which the best size of firm is small relatively to the size of the market; for the advantages of large-scale production have their limits, and in the majority of instances are outweighed by the inflexibility of the large organization. In most cases, the greater the number of competing suppliers, the more certain the community will be of getting efficient service.

The great growth of monopolies which has taken place seems to have been due much more to financial tricks and to government support than to any natural economic forces. Many experts believe that the reform of the company law, the removal of tariffs, the repeal of various laws favouring the large firm at the expense of the small, and the strengthening of



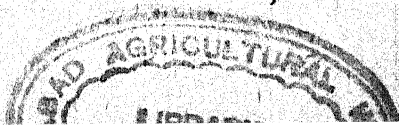
the law relating to restraint of trade would soon destroy most monopolies. But this brings us right up against the fact of economic and political power: how so to organize public opinion and public power as to defeat sectional interests seeking to shelter behind the state. In the United States of America some experiments have been made on these lines; laws have been passed prohibiting certain monopolistic practices, and special bodies set up to enforce them. But partly because the laws have been drafted vaguely, and partly because of the hostility of the courts, the experiment has not been very successful, though without doubt it has had some effect in restraining monopoly. What is most necessary is that public opinion should be educated and mobilized; in one sense economic problems cannot be solved until the democratic community has devised the machinery and acquired the will to protect itself against exploitation by minorities.

(3) *Resistance to Change*. Next comes another big disadvantage of using monetary incentives to secure that the right things be produced—the hardship some producers suffer as a result of changes in taste which diminish their incomes. If the consumer is free to change his mind as he likes, and to make use of new sources of satisfaction, people who have been engaged in preparing things for him may suffer a loss of income. For example, increasing choice of oil and hydro-electricity as sources of heat, light and power has meant that many people who had invested capital in coal-mining, and workers who have been in the industry from boyhood, have had their incomes curtailed; some employers are making losses, and some workers are having to put up with



low wages and unemployment. Similarly the development of motor traffic and the steadily increasing preference of consumers for travelling and sending their goods by road rather than by rail has unfortunate consequences for shareholders and workers in the railway industry. So it is too with the cotton industry, faced with the decline of the demand for its products. Industry is in a constant state of flux; in response to consumers' demands some industries are dying while other new ones are growing up. So the decline in the old staple industries—coal, cotton, shipbuilding, agriculture, railways—is paralleled by the rise of new industries—motors, wireless, gas, electricity, milk and so on—whose wages and profits are much higher than those of the declining industries and serve as an incentive to people to transfer their resources.

Now if there were adequate mobility in the economic system, economic progress would not present such difficult problems. As fast as the consumers' tastes changed, some resources could shift out of declining industries into expanding ones without any loss of income, and therefore their owners would have little incentive, beyond inertia, to prevent change. But there is not perfect mobility. Some resources, such as machinery which is specific and capable of turning out only one type of product, cannot shift at all, while others, such as a worker highly skilled in a particular craft, may find on shifting to another job that they are not particularly good at it, so that the change in consumers' demand makes them permanently worse off than before. This is to some extent a penalty we pay for specialization; you cannot be expert at several different jobs



at the same time, but to be expert at only one means that your income may fall considerably if the demand for that particular service diminishes.

The ideal solution of the difficulty would be for society to spend much money on facilitating mobility; to subsidize migration; and to subsidize low incomes, so that no worker need fear starvation because consumers' tastes have changed. But in the absence of adequate mobility the natural reaction of the producer is to try to resist the change in consumers' demand which is diminishing his income. If laws were passed compelling people to travel by rail instead of by road, to wear cotton stockings instead of silk, to burn coal instead of oil, and so on, transference would no longer be necessary. But would the community be better off? The producers of these particular commodities would be better off, but all those who were compelled to consume what they would rather not have had would be correspondingly worse off. Most people are agreed that such laws would be an intolerable interference with personal freedom in order to benefit vested interests.

Yet there is more than one way of achieving the same object, and vested interests have found many other methods of protecting themselves at the expense of the consumer, which pass more easily partly because they do not look so bad and partly because the public does not realize that they have the same result. The boldest device adopted in Great Britain is that of the railway companies which in recent years have persuaded Parliament to pass much legislation restricting the growth of road transport. Less straightforward devices have been

used by the agricultural and shipping interests which have persuaded the state to give them subsidies; people are not compelled to buy British beef or wheat, but the state takes money away from them by taxation and gives it to farmers, so that the result is nearly the same—farmers are better off, and the public has less money to spend on other things. Another method is to get the state to create a monopoly—Parliament has for instance organized the producers of milk, potatoes, hops, pigs, cotton goods, coal and iron and steel into monopolistic associations. This method has become very popular because it does not look as bad as a subsidy and can be defended by specious and dishonest arguments about controlling competition, planning, and co-ordinating industry. But its results are exactly the same; with a monopoly producers can charge higher prices than they can without it, so that the consumer is just as badly off as if he were taxed and a subsidy granted, or a law passed compelling him to buy from these producers. Or again, producers may plead for a tariff, which by reducing foreign competition, has the same effect.

In the nineteenth century men became convinced that restrictions of this kind were bad because they held up progress; how much poorer would the country be if the canal interests had succeeded in restricting the development of the railways in the way in which the railways are now restricting motor traffic! It is for this reason that one set of restrictions after another was swept away, and governments allowed very little interference in business lest they be tempted to subsidize one producer at the expense of the rest. The decline of political and economic

freedom, however, has seen the return of monopolistic restrictions under new names (their supporters usually claiming to have discovered "new economic laws") as one group after another has bent Parliament to its will. We are once more face to face with the problem of power as groups within society use political and economic pressure to secure an allocation of resources most favourable to their interests, and till we learn how to control sectional interests and subordinate them to the general good, there is no hope of securing anything like an ideal allocation.

Two things are necessary. The first is to teach the public to recognize exploitation in all its various disguises, and to develop a democratic machinery which will refuse it the sanction of the state. The second is to create conditions which minimize people's incentive to exploit in this way. The fundamental cause of the trouble is immobility—the producer whose income is diminished by the change in demand finds himself unable to shift into other industries and occupations offering better prospects, and therefore tries to bring pressure on the public to maintain its former choice. In a later chapter we shall have more to say about immobility and the ways in which it can be reduced. Briefly they are the use of labour exchanges, instructional centres where workers can learn new trades, subsidies to migration, and the removal of restrictions on entering new occupations. If people could be assured by such measures that they could pass easily from one industry into another without substantial loss of income, the fear which drives them to resist changes in demand would be minimized. After all, violent changes are not the rule. Usually all that is

necessary is that a few of the producers in an industry should shift elsewhere; if they move easily, the rest of the industry suffers no loss. It is only when the marginal producers are encouraged to remain that their output pulls prices down and involves the whole industry in losses.

(4) *Inequality*. Finally it is a most serious drawback that when people are paid according to the value of the work they do, incomes may be very unequal. Not merely will a few people whose services are in great demand, like film-stars, have fantastically large incomes, but other no less deserving people for whose special talents the community has little taste, or people who are not very fast or very clever workers, may have very small incomes, perhaps not even large enough to maintain them at a reasonable level of comfort. In practice, apart from laziness, the main reasons why people receive different incomes are first unequal opportunities and secondly unequal capacities.

The concentration of property in a few hands gives to the rich better economic opportunities than those available to the poor—not only in the direct form of the income from the property, but also in giving the children of the rich better educational opportunities and better chances of securing the most remunerative jobs. If this source of inequality were removed, the greatest source of income disparity would disappear; this problem we shall discuss more fully in the next chapter. Apart from this, another source of unequal opportunities is monopolistic restrictions; when the members of any particular industry, craft, trade union, or profession are able to restrict their numbers, they thereby

preserve for themselves special privileges not available to the rest of the community. Measures directed against monopoly therefore tend also to produce equality of opportunity and of income.

The other source of unequal incomes is differences in capacity, and in the value which society places on abilities of different kinds. Even if all children were born with equal economic opportunities, receiving the same educational advantages, and meeting no bars against entry into the occupations of their choice, some would still earn more than others—the world's favourite comedian, for instance, more than the world's fastest typist. But the disparity in incomes would certainly not be nearly as great as it is to-day, since the highest paid occupations would soon attract enough entrants to bring their earnings near to the common level, and it is doubtful whether such disparity as would exist would arouse much comment. Most people who to-day feel strongly about the extremes of riches and poverty would be satisfied by a world in which all children started with an equal chance irrespective of the economic status of their parents—an equality of chance such as could be secured by the payment of family allowances, so that members of large families were not handicapped, by special allowances for orphans, by free secondary and university education to all who prove fit for it, and by recruitment into industry solely on the basis of character and ability. For most people recognize that to pay equal incomes would be a drawback, in so far as payment by results is necessary to secure the fullest and best utilization of the community's resources.

Nevertheless, even such inequality as is due to

differences in capacity can be modified by taxation. The very high incomes can be taxed, and are indeed ruthlessly taxed in most progressive communities. As for those incomes which fall below the minimum considered necessary to a reasonable comfort, owing to incapacity, physical or mental, two courses are possible. The most popular is for the state to lay down minimum wages and prohibit any person from working for less than these wages; this is done in Great Britain for instance by trade boards and agricultural wages boards. Its disadvantage is that workers whose services are of less value than the minimum wage may be discharged and become unemployed, so that their last state may be worse than their first. The other course would be to pay subsidies to persons in receipt of low wages, just as at the opposite end people with high wages are taxed. This proposal is also sometimes met in other forms. One is that taxation should be high enough to enable the state to pay to each person a certain minimum, e.g., 15s. a week, in addition to whatever wages he or she may or may not be earning, so as to secure to everyone at least the minimum necessities of life. A variant of this is that the state should not pay money, but should instead issue tickets entitling everyone to so much bread, so much clothing, and so much house room per month. Yet another variant is that the state should subsidize producers of certain necessities, such as bread and houses, so as to make these commodities cheap in the interest of the poor (e.g., housing is subsidized in Great Britain). These two last variations are, however, subject to the general objection we raised against rationing earlier in this chapter, on the ground that

it might be better to pay the money to the poor and allow them to spend it as they think fit. Nevertheless, whatever methods may be chosen, it is clearly within the power of the state to place limitations on the extremes of wealth and poverty. Doubtless such limitations may restrict production, the taxation of the rich reducing their incentive to work, and the subsidizing of the poor encouraging laziness, but most people consider that the advantage of a greater equality of income is well bought even at this price.

### CONCLUSION

To summarize, it is clear that the problem of securing the ideal utilization of the community's resources is a very difficult one. There is room for dispute on such questions as how far the government should be allowed to interfere with the individual's right to work as much or as little as he likes, and to spend his income as he likes; how far equality of income is compatible with freedom to choose one's occupation; and how the disadvantages of unequal incomes may best be overcome. These and other questions constantly occupy the attention of thinkers and legislators, and every citizen should make up his mind about them, for to have no opinion is to allow whoever can seize power to impose his own selfish solution.



## APPENDIX TO CHAPTER I

THE ALLOCATION OF RESOURCES IN  
WAR-TIME

The outbreak of war brings a sudden change in the relative scarcity and value of different commodities. All those commodities associated with the prosecution of war—uniforms, guns, corned beef and so on—are subjected to a sudden increase in demand. The production of such commodities has to be increased at the expense of others, of which the supply must correspondingly be curtailed.

## PRICE AND PRODUCTION CONTROLS

The ordinary forces of the market are not the most suitable for securing vast and sudden changes in the allocation of resources. If there were no special interference, resources would indeed move over to supply war requirements, but the change-over would be slow. The government would enter the market to buy up supplies; this would drive up their prices, and entrepreneurs in war industries, having high profits, would be able to pay higher wages and higher prices for raw materials in order to attract resources from elsewhere. Eventually men, machinery and other resources would transfer to the war industries to supply the government's needs. But the process of transfer would take too long. The price mechanism is not meant to deal with gigantic changes in demand.

There is another reason why the switch-over is not left to the ordinary forces of the market. The

great increase in demand for war materials would push their prices up till such time as new resources switched over to meet the demand, when prices would fall again. In the meantime huge profits and abnormal wages would have been earned by those persons who happened to be engaged in these industries at the outbreak of the war. It is generally felt to be undesirable that such persons should be enriched as the outcome of war, and so the public seeks methods of avoiding "profiteering" (the term is misleading, since wages and other earnings rise in the war industries besides profits).

For these two reasons governments in war-time do not rely on the price mechanism to secure their requirements, but take direct steps to secure the change in the distribution of resources demanded by the outbreak of war. Prices, profits and wages are more or less controlled, with the object of preventing some people from increasing their incomes (and incidentally keeping down the cost to the government of the things it buys). And instead of relying on high earnings to attract the resources it wants, it relies partly on voluntary response by producers and partly on commandeering. For example, people are asked to volunteer for service in the armed forces, in civil defence, in the administrative departments, on the land, and in other occupations where man-power is urgently needed, at salaries hardly higher and often lower than those obtainable in other employment. Similarly owners of motor vehicles, houses and other property required by the government are asked to offer it. But in so far as this voluntary response is inadequate, the government proceeds to commandeer what it

requires. Men are conscripted and compelled to enter the forces; property is commandeered; "priority certificates" are issued compelling firms to give first attention to urgent government orders; and so on. Freedom to choose one's occupation gives way to compulsory order. Some increase in prices and earnings is inevitable, but it can be kept in check.

### RATIONING

But this is not all. The diversion of resources to produce war requirements means that less resources are available for civil use—there is less food, less petrol, less entertainment, fewer doctors, fewer new cars and new houses, and so on. What is left has to be divided out among the civilian population. The ordinary price mechanism is quite capable of doing this, since according to the way in which people spent their money, the price of each commodity would settle at the point at which the demand just equalled the supply. The result of this, however, would be that the people with plenty of money would be able to secure supplies by bidding prices up to high levels, while the poor would get very little. This is another reason, in addition to the desire to avoid "profiteering," why the government fixes prices. But when prices are fixed, demand is greater than supply; accordingly queues begin to form, and those who can stand longest get such supplies as there are. Price-fixing cannot work equitably without rationing, hence governments are compelled to issue to each member of the public ration-cards entitling him to a more or less equal share in what-

ever is available, and no one is allowed to purchase more than his ration. The system is not very flexible, but people put up with it because they recognize that it is better than the alternatives.

#### ECONOMIC WARFARE

A country can only remain at war so long as its armed forces and civilians can obtain essential supplies. It is therefore a recognized object of warfare to disorganize the economic system of the enemy so as to force him to surrender. This can be done in various ways.

Direct measures consist in attempting to destroy or close down by military action factories, mines, roads, railways and other equipment in enemy territory. Aeroplanes may bomb factories and railway junctions; armies may occupy industrial districts; navies may destroy enemy ships and harbours. "Blockade" and "Contraband" may also be used. Blockade consists in stationing warships along the enemy's coast and refusing to allow neutral ships to pass. It is very difficult to enforce in modern days because submarines, aeroplanes and mines make it dangerous for warships to congregate along an enemy coast. Consequently in the war of 1914-18 Great Britain resorted not to blockade but to contraband. The latter recognizes the right of neutrals to trade with the enemy, but permits a belligerent power to prohibit neutral ships from carrying to enemy destinations certain specified commodities which may be useful to the enemy in prosecuting the war. Neutral ships may be searched, and any ship carrying contraband may be seized. As the

list of articles is fairly extensive, a country commanding the seas can effectively prevent the enemy from getting essential supplies from neutrals.

By less direct measures a country may try to divert neutral trade from the enemy. One method is to offer neutrals high prices for supplies which would otherwise be sold to the enemy. Another is to bring pressure to bear on neutrals in debt or otherwise economically dependent, in order to persuade them to send no supplies to the enemy.

Countries anticipating war make various economic preparations. One is to become as self-sufficient as possible, so that if foreign supplies should be cut off, the country can supply its own requirements. Thus the Nazi government in Germany has always had self-sufficiency as a principal item on its programme. At the same time, a country which expects to be able to obtain foreign supplies (e.g., Great Britain, commanding the seas) devotes its attention rather to making sure that it will have the means to get its supplies from abroad. Ships and railways have to be extended and maintained in good condition; moreover as neutrals will not supply their goods without something in return (except in so far as they are willing to make loans), the country must be in a position to export goods which the neutrals are willing to accept, or gold, or failing this must have foreign securities (claims to money or property) which it can hand over in exchange. In the present war it is a weakness of Germany that, while not quite self-sufficient, she has little gold and few commodities to export, and very few foreign securities, and therefore will be unable, quite apart from blockade or contraband, to get as much as she

wants from abroad, unless she finds neutrals willing to take the risk of making loans to her.

#### FINANCING A WAR

The real cost of a war from the economic point of view is the commodities and resources which have to be sacrificed in prosecuting it; the men and property destroyed, and the commodities which would have been produced if resources had not been engaged in war (including as a commodity the leisure we forgo because some people have to work harder in war-time). A country can, of course, reduce this cost for the time being by borrowing from abroad, which is tantamount to using some other country's resources for fighting the war; but when it repays the loans it will have to bear the burden itself. Apart from this, the government's financial problem is how to find the money to pay for the resources it is using. This can be done in three ways—by extra taxation, by borrowing and by inflation.

The method of taxation requires little comment. By increasing the amount it takes in income tax, death duties, taxes on commodities, and so on, the government can if it wishes get all the money needed to pay for the war.

It can also borrow from its citizens. This is often more convenient for the public. Suppose for instance that there are two brothers each possessing £1,000, one of whom has his in the form of cash while the other has his in the form of a house. If the government taxes them each £200, the brother with the house may be embarrassed since in order

to raise the money he may have to sell his house. He may prefer to borrow the money from his brother who has idle cash, undertaking to pay it back by instalments with interest in the future. In this case the full burden of the war falls immediately on the brother who has cash, while the other continues as before, but the situation is gradually reversed in the future as the brother with the house saves his share and repays the loan. This is what in effect happens when the government borrows to finance the war; the full cost falls at the time on those who lend it money, while those who have no money to lend are for the time being not directly affected. But when after the war the government raises taxation to repay the loan, the burden is gradually spread over the rest of the community. The real cost *from the point of view of the country taken as a whole* is borne during the war, but the distribution of the burden is such that only the investing classes ~~feel~~ it directly at the time, while the rest of the community feels it only when repayment begins. This is what is meant by shifting the burden of the war on to future generations: the present generation of *investors* bears it now, while future generations of *taxpayers* bear it when repayment begins after the war is over.

The third method of financing a war is inflation. If the government prints new banknotes, it can use them to pay for the resources it needs. But since there is more money being offered to acquire the same or a smaller number of commodities, each unit of money will only be able to buy a smaller amount of goods; that is to say, prices rise. This method of finance was practised by most countries during the

war of 1914-18, and accounts for the great increase of prices which occurred in those years. It is the simplest method from the government's point of view, but it is also the most inequitable. For the increase of prices brings high profits to all who have goods to sell; but those whose incomes are fixed, e.g. wage and salary earners, landlords and investors receiving a fixed rate of interest, suffer losses, because their money buys fewer and fewer commodities as prices rise. Rapid changes in the value of money are always a source of grave injustice and discontent. Hence taxation and borrowing are the most suitable methods of financing a war.

#### THE RETURN TO PEACE

At the end of the war the distribution of resources then existing becomes wholly inadequate. Men are ~~no longer~~ needed as soldiers, as munition workers, or in the other industries associated with war. The problem is then to transfer them to the industries producing peace-time requirements. It is obvious that if this process is just left to work itself out, great hardship must result, and indeed history tells us that most wars have been followed by exceptional misery as soldiers and others have suddenly become unemployed, and much time has elapsed before they could be reabsorbed into industry. Just as the price mechanism works too slowly to deal adequately with the outbreak of war, so it is too slow for the readjustments necessitated by the sudden cessation of war. A sensible government therefore must have a programme for facilitating the return to peace. Men and resources should be demobilized gradually



instead of being flung on to the market, and financial assistance should be provided to facilitate the expansion of peace-time industries. The problems of peace are no less difficult than those of war, and call for generalship of no lesser calibre.

#### SUGGESTIONS FOR FURTHER READING

Any textbook on economics will explain how prices are formed and the functions they serve; good introductory works are Benham: *Economics*, and Scott: *Approach to Economics*. For a forceful statement of the case for equality of income consult Shaw: *Intelligent Woman's Guide to Socialism and Capitalism*. On the various forms of restrictionism consult Robbins: *Economic Planning*.

## CHAPTER II

### PROPERTY

**I**N discussing the allocation of resources in the last chapter we said very little specifically about property, but the general tenor of our remarks applies as much to it as to human resources. That is to say, it is necessary to secure that property, like human labour, be devoted to the best possible uses, and this object is most likely to be realized if the care of property is in the hands of persons whose incomes vary directly with the efficiency they apply to their job.

—In Great Britain, as in most other countries, the solution which is adopted is to allow private persons to “own” property, and to have, subject to the mass of regulations and controls laid down in the law of property, more or less full disposal over it. A land-owner has an incentive to look after the land and to see that it is used to produce those commodities in connection with which it yields the highest return; the better he looks after it, and the better it is used, the higher the income which he will get from it. According to calculations published by a distinguished statistician, Mr. Campion, something like 75 per cent or 80 per cent of British property is in the hands of private persons, whose incentive to see that the best use is made of it is the income it yields.

## THE DISTRIBUTION OF PROPERTY

Now property yields an enormous income—probably anything up to one-third of the total national income; hence it is very important that the distribution of property and its income should be on some basis of which most people can approve. When we come to examine the facts, we find that in Great Britain there is a strikingly uneven distribution of property. Indeed Mr. Campion's figures suggest that three-fourths of the adult population (i.e. over 25 years of age) own no property at all, or less than £100, two-thirds of British property being owned by only 2 per cent of the population.

How is this very unequal distribution to be explained? To some extent it reflects the fact that some people work harder and are more thrifty than others. But very much property is owned by people whose only justification is that they have inherited wealth from someone in the past. To some people this seems sufficient justification. The fact that five hundred years ago an ancestor enclosed the common land (an act of questionable morality) is considered good reason why a man should receive large rents to-day. Other people attempt to justify this concentration of property in the hands of a few who pass it on to their children and keep it in the family on the ground that it makes possible the existence of a leisured class able to act as leaders of society; and though most people who are not lucky enough to belong to that class do not attach much weight to this argument, it receives in some circles a support which should not be ignored.

On the other hand, there is much to be said against the concentration of property in a few hands. It produces an atmosphere of social snobbery and a gulf between rich and poor which is not conducive to harmonious relations within the community. It leads directly to a similar maldistribution of income, and its indirect effects on the distribution of income, though more difficult to trace, are no less important. The children of the propertied have the best start in life, not only because they can enjoy a long and expensive education, but also because the influence of patronage secures them good jobs without difficulty. To belong to the propertied classes is thus to have something like a monopoly of the best economic opportunities to the exclusion of the propertyless and their children. And finally the propertied are able to constitute a special group whose influence over the state in matters of legislation is beyond all proportion to their numbers. This aspect has so profoundly impressed some political philosophers that they go so far as to assert that in practice even the democratic state is so dominated by the small band of property owners that it is hardly more than an agent in their hands for exploiting the poor. Whatever the truth of this contention, it is not possible to calculate exactly what influence the maldistribution of property has on the distribution of income. Mr. Colin Clark has published statistics which show that 90 per cent of the working population receive only 50 per cent of the national income in Great Britain, while a small class of  $1\frac{1}{2}$  per cent (comprising persons receiving more than £1,000 per annum) between them take a quarter of the national income; and it is probable that the mal-

distribution of property accounts to no little extent for this very uneven distribution of income.

The relative merits of an equalitarian society and one in which an aristocracy is maintained by an uneven distribution of property must be weighed by each reader for himself; this book is not a political tract designed to support one side or the other. All that remains in this chapter is to examine some of the weapons with which some countries with equalitarian leanings seek to modify the distribution of income resulting from an uneven distribution of property, and to see what problems their use creates. Let us take three of these weapons—trade unionism, taxation, and the redistribution of property.

#### TRADE UNIONISM

The struggle for higher wages is the method of redistribution which appeals most strongly to the worker since it is the weapon he can most effectively use by direct action. But unfortunately it is probably the least efficient method of redistributing income, since it is so liable to have effects different from those which are intended. For, as we shall see, a considerable part of any increase in wages secured by one trade union often comes out of the pockets not of the employers but of other workers. And the same applies to the edicts of the trade boards and agricultural wages boards set up by the government to fix minimum wages in specified occupations.

For what is likely to happen when a trade union or trade board succeeds in raising wages? There are five cases in which the whole of the gain may accrue to the working classes, and we shall set them out

first. Then we shall examine the four cases in which the workers who gain may do so only at the expense of other workers.

(1) The increase of wages will compel the entrepreneur to re-examine his methods, and if he has been running the firm inefficiently before, he may discover new economies which make it possible to pay the increased wages without any loss to himself or anybody else. This however is not a very likely case.

(2) The workers may have been receiving such low wages that their physical capacity was impaired; or they may have been so discontented that they were working half-heartedly. In this case increased wages will enable them to feed themselves better and thus to increase their output, and if this happens, the increase will pay for itself. This is most likely in trades where wages are very low, and is the principal justification for trade boards.

(3) The entrepreneur may be able to pass the extra cost on to property owners, by paying them lower rents or lower dividends. It is seldom that the whole cost can be passed on in this way, as property owners usually have alternative uses to which they can put their property if its yield is reduced. The chance is greatest where wages are being raised everywhere at the same time, but even then, as we shall see in a moment, it is not very great.

(4) If the worker has been receiving less than the value of his product, the entrepreneur will simply be deprived of an illicit gain, and the worker will gain correspondingly. In a competitive system each worker would receive a wage equal to the value of what he produces; for if he received less than this

entrepreneurs would scramble among themselves for the chance to exploit him, and by playing one off against another he could get a wage high enough to reduce the exploitation to zero. The real world, however, is not so competitive as this; wages tend to stick at customary levels; feelings of loyalty reduce the incentive of workers to leave the old firm in search of higher remuneration; class feeling restrains some employers from enticing away the employees of others; and above all, employers frequently agree, tacitly or explicitly, not to pay wages above a certain level. Where such monopolistic elements exist, action by trade unions to secure higher wages is wholly to the benefit of the working classes.

(5) Even where he has not been exploiting his workers, the entrepreneur will have to bear the full burden of the increase if he cannot pass it on. This case is most unlikely, for entrepreneurs have so ~~many~~ alternative occupations open to them and so many chances of passing on costs, that their incomes are not easily reduced in this way.

These, then, are the five cases in which the gain secured by the workers whose wages the union has forced up, will not be at the expense of other workers. Now we come to the four cases, unfortunately much more probable in practice, where what is gained by one worker simply comes out of the pocket of another.

(1) The entrepreneur's most likely reaction is to pass the burden on by raising prices. If the commodity is one consumed entirely by the rich and propertied classes, they will bear the brunt of the burden. But the vast majority of commodities are

consumed either directly or indirectly by members of the working classes. If prices are raised to pay higher wages, it is workers who have to foot the bill. Again, as the price increases, sales decline and some workers have to be dismissed. These workers too are being made to contribute to the increase secured by their fellows. They may remain unemployed; or they may seek employment in other industries, reducing the scarcity of labour (and therefore tending to pull down the wages) in those industries—thus forcing the workers already there to contribute in lower wages, or wages which do not rise so rapidly, to the increase secured by the first group. The secretary of the first trade union will point with pride to what the workers in his union have gained from the higher wage; the loss to other workers through prices, unemployment, and pressure on wages elsewhere is seldom realized, but nevertheless real.

(2) If the increase cannot be passed on by raising prices—for instance if the industry is subject to foreign competition—firms or parts of firms may have to close down. It will no longer pay to use the less efficient machines, or to cultivate the less fertile fields. Some workers thus become unemployed, or are forced to seek work elsewhere, bringing wages down there; and the loss of these workers must be set against the gain of the others.

(3) An increase granted to one grade of labour may be passed on to another in the same firm. For example, an increased payment to engine-drivers may be met by reducing the pay of stokers, or by withholding an advance which would otherwise have been granted.



(4) Finally the entrepreneur may be driven to substitute some other factor, such as capital, land or some other type of labour for the workers whose pay has been increased. The various factors of production are combined in whatever proportion is cheapest at existing prices. If one factor then becomes more expensive, others will be substituted for it to some extent. Thus the entrepreneur may decide to use less labour per acre, or more capital, discharging some of his workers who will be paying for the increases received by those who remain.

It is the ease with which an entrepreneur can pass on an increase of wages in one of these four ways that makes this method of redistributing income so uncertain. For while there is some chance that other classes may have to contribute, the bulk of the cost is likely to be found by other workers.

It may be thought that the best remedy for this is for all workers to press for higher wages ~~simul-~~ simultaneously; but to believe this is to be tricked into an error known as "the fallacy of composition." In so far as one group secures its advantages at the expense of the rest, if they all act together the result is not that they all gain, but that they neutralize each other so that none gains. In practice, an all-round increase of wages is most likely to lead partly to an all-round increase of prices which by increasing the cost of living offsets some of the increase in wages, and partly to an all-round increase of unemployment, the gain of some workers being at the expense of those who become unemployed. In a later chapter we shall see that this is exactly what happened recently when the experiment was tried by a "left" government in France.

The fact of the matter is that the interests of one group of workers organized in a trade union are not in all respects identical with those of other groups. On the contrary, action taken by one group to advance its interests may well be at the expense of others. This applies not only to wage negotiations, but also to attempts to limit the number of workers available for employment in a given occupation by onerous apprenticeship regulations and restrictions on "dilution," and to "demarcation" rules which seek to preserve to members of a given union all jobs of a particular type. The trade union movement consists of a number of horses each straining to advance in its own direction, and it is not surprising if they sometimes trample on each other. The leaders of the movement are of course fully aware of these problems; they have for instance set up a special committee under the auspices of the Trade Union Congress to settle demarcation disputes. But on the major issue of wage negotiations, there is as yet little machinery for securing that the actions of one group of workers shall not damage the interests of others.

The field in which trade unions can act without damaging each other is actually quite wide. By collective bargaining they can prevent petty exploitation of workers whose mobility is not very great, as well as exploitation of the workers as a whole by powerful combinations of employers. Collective bargaining becomes dangerous to the movement as a whole only when one group is seeking to exact conditions which will react unfavourably on the others. Further, the backing of his union gives to the worker a chance to assert his dignity against the

petty tyranny to which some employers are prone, and this is an advantage of no little importance in communities where social snobbery is rife. Again, the worker is able to insure himself with his union against sickness, unemployment, death or other misfortune; the insurance facilities of trade unions were once their greatest strength in the days before compulsory government schemes were started. Finally, the trade union movement is the backbone of the labour movement, through which the worker brings pressure to bear on the state to secure legislation increasing his well-being at the expense of wealthier classes in the community. If the successes of one union are sometimes gained at the expense of other workers, this is merely an argument for closer inter-union co-operation to prevent one union from taking action which may damage the interests of other groups of workers.

#### TAXATION

The second method of redistributing income is through taxation. For example, in Great Britain, income tax, surtax and death duties are so graded that they fall most heavily on the well-to-do, and part of the proceeds of taxation is used to contribute to the cost of maintaining the social services—education, housing, health and unemployment insurance, and so on. It is impossible to estimate with any degree of accuracy what effect taxation has in redistributing the national income, but it is probable that a fair sum is transferred in this way from the rich to the poor.

Taxation too can be passed on to some extent, but

it is much more difficult to pass it on than to pass on an increase of wages. Accordingly this method of redistributing income is so far superior to the method of struggling for higher money wages that it is unfortunate for the working classes that their leaders' minds are concentrated so much on the level of money wages and so little on the weapon of taxation which could yield much more fruitful results. Thus, for instance, when the "People's Front" government came into power in France it devoted itself to all-round increases in money wages which left the workers hardly any better off, while in the field of taxation, where it might have been very successful, it attempted hardly anything. Clearly there is need for much new and hard thinking on strategy inside the labour movement.

#### REDISTRIBUTION OF PROPERTY

The third method by which the uneven distribution of income can be modified is by a redistribution of property. In this connection there are two schools of thought. The first wishes to retain the principle of private property, but to secure as wide a distribution of property as possible, especially through the use of the inheritance laws; the second is opposed to private property on principle, urging that all the instruments of production should be nationalized.

Statistics show that inheritance is principally responsible for the continued uneven distribution of property. In most countries the government claims a portion of all estates at death, but at least in Great Britain the amount taken is not large enough to make

any very significant impression on the distribution of property. The reforms suggested are twofold. First the basis on which the death duties are levied at present is the total value of the estate, though there are also small duties payable by the inheritor varying with the size of the individual legacy. It is proposed that the amount of the duty should depend not on the total value of the estate but on the size of each bequest, so that the greater the number of persons benefiting under the will and the smaller the amount received by each of them the less would be the duty payable. Provided the provisions governing gifts *inter vivos* (i.e. gifts made during the donor's lifetime) were tightened up to prevent evasion, this system would encourage testators to distribute their estates widely, and help to reduce the concentration of property. Secondly, it is suggested in some quarters that limits should be placed on the amount which any one person should be allowed to inherit, and that the limits should depend on the economic position of the inheritor, so that, for instance, widows, orphans and servants could inherit more than persons in less needy circumstances. The limits need not be absolute, but could be secured by taxing heavily any sums received above the desired level. Thus the dependants of the deceased could be protected by allowing them to receive as much as is necessary for their education and maintenance, while at the same time the system would encourage testators to leave their estates as far as possible to persons who were not already well provided for. There can be no doubt that the net effect of these two proposals would be soon to achieve a very wide distribution of property,

especially if the state used the sums received in taxation to provide equal educational and other opportunities for its citizens. An objection which is sometimes raised is that such heavy taxation would discourage people from working hard and saving in so far as their main purpose in doing so is to "found a family." How far this is true, and whether it outweighs the merits of the proposals are points in dispute.

The other school of thought is socialist, i.e. it urges that all land and the property of all industrial undertakings should be owned by the government. The objections usually raised, in socialist literature, against private property are however usually only applicable to societies where property is very unevenly distributed, as few socialists have realized that an equalitarian distribution of private property presents an alternative remedy for the abuses they seek to cure. In fact, the problems of a democratic socialist society with equalitarian principles (for a socialist society can be just as dictatorial and unequal as any other) are very similar to those of a democratic society in which private property is equally distributed. (1) There is the same need to decide how far the state should plan production, and how far it should be left to the individual consumer, spending his income freely in the shops, to guide resources into the right channels. Some people believe that a socialist society must necessarily be planned from the centre, but this is not so. How much planning there should be, and how much free choice, raises the same problems whether property is nationalized or not. (2) Incentives present the same problems; how far are monetary incentives to

be used? If they are used, there will be inequality of income, since the work of some people is more valuable than that of others. Moreover, groups of producers will have the same incentive as in countries where property is not nationalized to restrict entry into their professions in order to be able to extort high wages, or to bring pressure to bear to resist changes in demand or in the technique of production which are likely to reduce their incomes—for whether property be nationalized or not the producers in each industry will still be trying to get as much for themselves as they can. (3) The disposal of property also gives rise to the same problems in both types of society. For in a socialist system, as elsewhere, it is desirable that every piece of property should be put to its best use. Where property is in private ownership the owner has an incentive to look after the property well and to see that it is put to its best use; a socialist society has to have persons responsible for fulfilling these same functions. Now in a private property system such people are paid by results—the better they look after the property the more they earn; a socialist society will probably be driven to adopt some similar incentive, paying its officials in accordance with the results yielded by the property they control (as measured by the interest, rent, or profit it earns) and the more it adopts this principle the more closely it will resemble a private-property system. Moreover it will have to give its officials a free hand, for unless they are encouraged to take risks with the property they control, economic progress will be held up, since it is the men who are willing to stake their all on a project who have contributed most to economic progress.

(4) Finally, property must not be a source of arbitrary economic power. In a society where private property was widely diffused on a more or less equalitarian basis, it would be no obstacle to equality of income or opportunity, but the difficulty would be to maintain this equalitarian distribution. Similarly in a socialist state, if the responsibility for looking after the community's property were widely decentralized, and the responsible persons subjected to adequate control, there would be nothing to fear; but might there not be a danger that control over society's property would fall into the hands of a few men—politicians or civil servants—who would act no less arbitrarily than the owners of property in unequalitarian societies where property has not been nationalized? The necessity to prevent overwhelming economic power from passing into the hands of a few who use it arbitrarily is present no less in the socialist than in the private property system, and it is matter of opinion which type of system would succeed most easily in this task.

Finally, all proposals for redistributing property have to reckon with the present owners of property. If the state were to pay them the full value of their property, no real redistribution would have occurred; the rich would be just as rich as before, and the poor just as poor. Therefore, some people would like to expropriate them completely, either by violence, or by levying very heavy death duties, while others, more moderate, suggest that they should be compensated, but with less than the value of their property. However, the political influence of the propertied is very great; and in some parts of the world they have shown themselves to be prepared



even to resort to violence in order to protect the *status quo*. Indeed, much of the troubled history of the world in the last twenty years can only be understood in terms of the conflict between those who own property and those who do not. In this field, however, we pass out of the realm of economics into the realm of political action. Every state will be forced within the next few years to make up its mind what it will do about the distribution of property, and in analysing the various possible solutions we have ended our task.

#### SUGGESTIONS FOR FURTHER READING

Statistics showing the distribution of income in Great Britain are given in Clark: *National Income and Outlay*, and the distribution of property in Campion: *Public and Private Property in Great Britain*. Laski: *The State Theory and Practice* is an attack on private property; Wedgwood: *The Economics of Inheritance* an examination of the laws of inheritance and their effects. Trade union objects and structure are set out in Lloyd: *Trade Unionism*, which should be supplemented by a book on the theory of wages, such as the works of that name by Dobb, Hicks or Rowe. On socialism consult Pigou: *Socialism versus Capitalism*.

### CHAPTER III

## INTERNATIONAL ECONOMICS

WHY do we have to give separate treatment to international trade? What is there which from the economic point of view distinguishes the trade between Newcastle and London from the trade between Amsterdam and London? The answer is that the fact that the two cities are under two different governments may give rise to special complications. If governments never interfered in commerce there would be no need for a special chapter on international economics; but they do. First, they interfere with money, so that where there are different governments there are usually different monies in use. And, secondly, they interfere with trade, imposing tariffs or restrictions on migration, and sometimes even going so far as altogether to prohibit commerce with countries with whom they have declared themselves to be at war. In this chapter then we shall be examining the ways in which governments may interfere in international trade, and the motives and results of such interference; and as their actions lead to international quarrels and even to war, we shall have to glance at the political framework of international affairs, with a view to discovering how a change of framework might affect economic relations.

## CURRENCY QUESTIONS

Let us begin with currencies. Different countries need not necessarily have different currencies. In former days merchants of most countries spontaneously used gold and other precious metals as money, and though in different countries a piece of metal might have different names and be stamped by different kings, its value could easily be ascertained in any country by assessing its weight and fineness.

Problems emerged only when paper money became widely used. Unlike gold, paper has only a small value. When a king stamps his name on a piece of paper, calls it a banknote or currency note, and announces that this paper is henceforth worth as much as, e.g., one ounce of gold, his subjects may be compelled to accept his ruling, but foreigners are under no obligation to take the paper money in settlement of debts. So long, however, as the government is willing and able to give an ounce of gold to anyone who presents the note, it will be freely accepted and will serve as money. Until the outbreak of the Great War in 1914, this was the position in Great Britain, the United States of America, and many European countries. Gold and paper money circulated side by side and were freely accepted. And since everyone knew the amount of gold he could get for an English banknote, the amount he could get for an American note, and so on, the value of each currency was fixed in terms of all the rest.

The War put an end to this. During the War governments called in the gold coins circulating in

their respective countries, printed paper money to replace them, and refused to exchange paper money for gold. This state of affairs continued after the War until about 1925. As no one knew how many ounces of gold he would get for an English pound note in a month's time, or how many for a German mark note, the value of the pound in terms of marks was not fixed, and in fact fluctuated widely. It does not require much thought to realize how great a nuisance such fluctuations are. International trade is greatly handicapped; if the seller demands to be paid in his own currency, the buyer hesitates to buy because he does not know how much of his own currency he will have to give up to get the seller's currency; and if the transaction is to be in the buyer's currency, the seller does not know how much he will get for the money paid by the buyer. International trade plays so large a part in the economy of most countries that they just cannot afford to have it strangled by such uncertainties.

The uncertainties of the early twenties were brought to an end from 1925 onwards as one country after another returned to the "Gold Standard." The method of doing this was simple. A country had merely to announce that it was prepared to give a definite amount of gold to anyone who presented its banknotes, and similarly to buy gold at a fixed price. Since people then knew how much gold the pound would fetch, and how much the dollar, the franc or the mark would fetch, they knew automatically how many dollars, francs or marks the pound was worth. The value of each currency was fixed in terms of the rest.

But how did the government decide at what price to buy and sell gold, and therefore what should be the rate of exchange between its currency and the rest? This was a most crucial decision since much depended on what rate was actually fixed. The real value of the franc is the amount of goods which you can buy with it; and similarly the real value of the pound is the amount of goods which a pound can buy. Hence the correct rate of exchange between pounds and francs is that which brings the prices of French goods (the inverse of the amount of goods which you can buy with the franc) into line with the prices of British goods. Suppose that the wrong rate of exchange were fixed, so that French prices were too low and British prices too high. Then, first, British industry would suffer; British consumers would buy from France as much as possible rather than from their own producers, and French consumers also would not find it profitable to buy in England. British exports would diminish, and imports increase. This, in turn, gives rise to another difficulty. If the imports and exports of a country are equal, no money need be exported to pay for its imports, or *vice versa*; the exports give it claims on foreigners which can be set off against the imports. But when the imports are bigger than the exports, the difference has to be met by exporting gold. In the case we are considering where British prices are too high, there would be a continuous drain of gold from Britain to France. A continuous outflow of gold is thus a sign that the currency is "over-valued" in terms of other currencies. Either the rate of exchange must be altered, so as to bring prices in all countries into line, or the country whose

prices are too high must take steps to reduce them to a level corresponding to the rate of exchange.

The Gold Standard, or any other system for stabilizing the rates of exchange, can only work if this principle is maintained. Either the correct rates of exchange must be chosen, or if the wrong rate is chosen, countries losing gold must reduce their prices and countries receiving gold increase their prices, until they are in line with each other; otherwise the country whose prices are too high will suffer unemployment, and will lose so much gold that a point may come where it is no longer able to pay for its imports.

Unfortunately, this is precisely what happened between 1925 and 1931. Great Britain returned to the Gold Standard in 1925 at a parity which made her prices too high in comparison with those of France, America and other countries. All might have been well if the countries had adhered to the rules of the system, those receiving gold taking steps to increase their prices, and others lowering theirs. France and the U.S.A., who were receiving gold, did indeed try to keep their prices up, but Great Britain, who was losing gold, did little to reduce her price level, so that she continued to be out of step, her imports being larger than her exports. The situation became worse after 1929, as a result of the slump, since this brought further alterations in the levels of prices in different countries, and in imports and exports, putting a strain on the rates of exchange adopted in 1925. Moreover, the slump affected confidence; foreign creditors began to withdraw their funds from certain countries; banks collapsed in Germany and

Central Europe, and even the Bank of England was hard put to meet its obligations. By 1931 gold was leaving the Bank of England so rapidly to meet foreign obligations that Great Britain felt herself compelled to abandon the Gold Standard, and most other countries soon followed her.

There followed a short period of economic war, each country trying to increase its exports by cheapening its currency, and by tariffs. The effects were disastrous; international trade shrank, the depression grew worse, and unemployment attained unprecedented levels. Eventually it was realized that there was more to be gained from stable currencies than from the confusion of frequent fluctuations. Many of the smaller countries fixed their currencies in terms of the pound, and now Great Britain, France and the United States have set aside special funds known as "Exchange Equalization Funds," and agreed to use these funds to keep their three currencies more or less in step with each other.

What can we conclude from this brief review of the currency problem? It is fairly clear that fluctuating currencies produce dislocation in international commerce, and are seldom in the interest of any of the parties concerned. Governments could avert confusion by agreeing to use one single currency, such as gold, refraining from issuing paper money; or if they do issue paper money, they could still avert confusion by adhering to some such system as the Gold Standard, and observing its rules. A still more radical solution would be to prohibit national governments from interfering in monetary matters, just as local governments have no power to issue

money, and to hand over all powers in this sphere to some central federal government. These problems will come up again at the end of this chapter, when the general problem of the international framework is under discussion.

#### TARIFFS

And so we come to the second way in which governments may interfere in international commerce—by imposing tariffs. A country is said to impose a tariff when it imposes taxes on goods made in foreign countries, thereby discouraging its subjects from buying abroad. What are the motives for imposing tariffs, how do they affect international commerce, and how far should individual governments be free to interfere in this way?

In the absence of interference, each country would tend to specialize in producing those commodities which yield it the highest income, and would buy the rest abroad. There are, however, a number of cases in which it is theoretically possible that a nation as a whole may benefit from the imposition of a tariff. First, given the opportunity to establish itself, a certain industry might come to flourish exceedingly in the country, but its growth in the early stages while labour is trained, sources of raw materials tapped and market connections made, may be handicapped by foreign competition. A tariff in the early stages would enable the industry to find its feet. The danger of tariffs protecting infant industries, however, is first that all sorts of infants which will never be able to grow up are presented for protection, and, secondly, that even



when an infant has grown up those who receive the subsidy refuse to admit that the time has come for it to stand on its own feet. For example, the motor-car industry in this country was originally protected as an infant industry, but the infant has never grown up. Continuous restrictions on the importation of foreign cars have enabled the motor-car magnates to become multi-millionaires, while, in contrast with America, the motor-car remains in this country a luxury for the well-to-do.

Secondly, if foreign producers are trying to kill an industry by dumping their commodities at a price less than their cost, so that when the industry is dead they may be able to put prices up to monopolistic levels, a country might be justified in offering some protection to its industry. But this argument must not be misused. It does not apply to all cases in which foreign producers are able to undersell the native industry. On the contrary, the more cheaply the country can obtain supplies from abroad, the better off it is; obviously it would be still better off if it could get them without paying anything at all. There is much misconception on this point; some persons argue that if the country buys too cheaply, those from whom it buys will be unable to afford to buy its exports. The correct way to look at the situation is that the more cheaply the country can buy its imports, the less exports it needs to send abroad in order to obtain them. Resources are thus freed which can be used to augment consumption at home. There may, of course, be some temporary unemployment caused in the export industries by hindrances to the speedy transference of resources to new uses, but is it not better to spend the national

effort on facilitating mobility than to make and export goods unnecessarily?

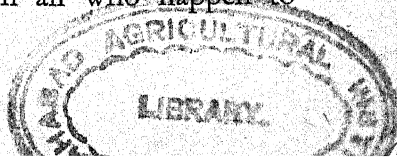
Thirdly, a country may decide that it wishes to be self-sufficient and so lose the benefits of specialization. For example, it may fear a war, and wish to have within its own frontiers all essential war industries lest its supplies be cut off by an enemy. Or it may merely distrust too much specialization, fearing to put all its eggs in one basket; for a country depending on a single industry may undergo great suffering if the demand suddenly diminishes for cyclical or other reasons, unless it can switch over rapidly to some other industry. To choose self-sufficiency is in general to choose poverty, but there are cases when it may in the long run be more profitable to choose what at the moment seems the less profitable path.

Fourthly, by imposing tariffs a country may theoretically be able to benefit itself at the expense of others. In this it is just like an individual imposing a barrier on his trade with other individuals. Such an individual would benefit if he were in a sufficiently strong bargaining position to be able to force other people to sell more cheaply to him. So also a country in a strong bargaining position might be able by imposing a tariff to get its imports more cheaply. But just as there are few people able to affect prices by reducing their purchases, so there are few countries able to affect prices by imposing tariffs. Large countries like Great Britain may be able to do so for some time, but even leaving aside the bad effect of this on international relations, and the possibility of war resulting, just as sellers would retaliate by boycotting the goods of any individual

who tried to exploit his strong bargaining position, so also the reaction of foreign countries to the imposition of a tariff is most usually to impose tariffs themselves. In the final result, trade is considerably reduced, and they are all worse off.

Finally, if an individual restricts his trading with others, by making himself poorer, he will have to work harder. Similarly the effect of a tariff may be to increase employment. It is not certain that it will; imports will be reduced, and so employment in the industries producing for home consumption may increase; but since the country reduces its purchases from foreigners they will be poorer and unable to buy so much from it. Thus exports will be diminished and unemployment will increase in the export trades. There is no reason to believe that the employment created in the industries producing for home consumption will more than offset the unemployment created in the export industries; it all depends on how the foreign countries react when their markets are reduced, and it may well happen that there is a net increase in unemployment. In fact, when this policy was tried by several countries in the depression of the early thirties, international trade shrank to such an extent that the depression was prolonged to an abnormal length. Compared with the other methods of increasing employment, which we shall discuss in the next chapter, the tariff is much too uncertain a weapon to be worth while.

In any case, the general answer to all these five exceptional cases in which a tariff may benefit the whole nation is that there is nothing which a tariff can do that a subsidy cannot do better. A tariff acts as an indiscriminate levy on all who happen to



consume the particular commodity, whether they be rich or poor; a tariff on wheat, for instance, forces up the cost of the poor man's loaf no less than the rich man's, in order to subsidize farmers, land-owners and agricultural labourers. A subsidy, on the other hand, comes out of general taxation which can be so levied as to fall most heavily on those best able to bear it. The tariff is thus a most inequitable type of tax. Moreover, once a tariff is imposed it is difficult to get it off again. A subsidy, on the other hand, comes up before Parliament annually for review; members are able to inquire whether the industry is really still an infant, whether foreign competitors are still trying to crush it, and so on. The importance of democratic control cannot be over-estimated; for in practice, the chief reason why people ask for tariffs is to advance their own interests, without caring what happens to the rest of the community. They ask for a tariff for the same reason that other producers ask for a subsidy or for monopolistic privileges, namely, that they wish to be better off by being able to raise the prices of the goods they sell without fear of foreign competition. And when they get the tariff they are of course better off, but only at the expense of the rest of the community, since the additional income they receive from charging higher prices comes not out of the pockets of foreigners but out of the pockets of their own fellow-countrymen, who are the ones paying the higher prices. The danger that minorities may seek to exploit the community has proved so great that no democratic device which facilitates resistance should be despised.

So far we have dealt with the tariff only from the

domestic aspect. If the country imposing it so seldom gains by doing so, what of the rest of the world? The answer is that the tariff is similarly ruinous to other countries. It diminishes international commerce and therefore impoverishes the exporter just as it impoverishes the importer. This is amply proved by the orgy of tariff-making which started around 1930; international trade diminished to such an extent that the slump which had begun in 1929 lasted longer than any previous one (this was not the only reason, but an important one). Why, then, it may be asked, are governments permitted to impose these restrictions? The fact is that we are up against a mixture of private pressure and ignorance—pressure on Parliament by powerful groups who stand to gain from a tariff, and ignorance on the part of the general public which allows itself to be fooled into believing that it is foreigners who will have to foot the bill. From the internal point of view therefore, what is necessary is to educate the public and to strengthen the machinery of democratic control. But what if this fails? Some people believe that no government should have the right to impose a tariff since it is thus interfering not only with its own people, but also with the people of other countries who will thereby be impoverished. We shall come up with this argument again later in the chapter when we discuss the international framework.

#### MIGRATION

Next we come to restrictions on migration. The importation of goods is, in a sense, a substitute for the immigration of producers, and just as the growth

of international trade, in extending the division of labour, has been the principal factor contributing to the rise in the standard of living in the last six hundred years, so the migration of people has played a very important part in increasing world prosperity. In the past Britain has received large numbers from abroad. She has welcomed them with open arms because they have brought with them skill and new industries which have laid the foundations of British prosperity. Lord Snell has ably described this phase of British history in his pamphlet, *The Foreigner in Britain*, from which we quote the following:

“No evidence has been presented justifying on economic grounds the exclusion of aliens from England and history lends no sanction whatever to any such proposal. Without the alien it is scarcely too much to say that English industry as we know it would not have existed. His influence upon it has been simply incalculable. There is scarcely any great industry in England that he has not either created or substantially improved. Since the time of the Norman invasion, wave after wave of immigrants has reached these shores. England was for centuries the South Africa of the continental emigrant. Sometimes the aliens came in search of economic prosperity, but more often to escape political and religious persecution, and sometimes they were deliberately imported by English merchants in order to undertake a particular class of work. We profited from their skill, and they, finding our free institutions congenial, prospered and sent for their brothers and cousins to join them. They came from all quarters and they touched no industry that they did not enrich. England was free, and she digested

her guests; they were absorbed into the great stream of life of the nation which they helped to virilize and to protect. They came as soldiers, merchants, farmers, artisans; they built castles, bridges, and they made roads; they laid down towns upon continental models; they changed our commercial system from the primitive natural economy to modern forms of exchange; they became bankers and moneylenders; they founded our fiscal and administrative systems; they taught us the art of weaving delicate fabrics, and they probably established the guild system out of which has developed the modern trade union. To them we owe the development of our cloth trade, with its subsidiary employments of dyeing and fulling. Our woollen trade developed in their hands, and they were employed as shearmen; they were employed at the mint to establish our coinage; they were linen-weavers and clock-makers; they provided the example of which the modern Friendly Society is the imitation; they improved the art of brewing and they taught us both ornamental and kitchen gardening; they introduced many vegetables into England, and they suggested many improvements in root crops, in the use of special manures, in the cultivation of artificial grasses, and in the methods of treating the soil."

The author continues with many examples of new arts and manufactures introduced by Italians, Germans, Dutchmen, Spaniards and Frenchmen. Such illustrations are

"sufficient to indicate the profound influence that the alien has had upon our commerce in the past, and there is no evidence that he is not capable of conferring fresh benefits upon us."



Of course the immigration of people has the same effect as the importation of goods. The community as a whole is better off, but certain producers are worse off since their goods are not now so scarce as they were before. Two and three hundred years ago such people protested volubly against immigration, but their protests were ignored. Unfortunately the situation has now changed. Since the War of 1914-18 heavy restrictions have been placed upon immigration into Great Britain, and vested interests have succeeded in imposing strict restrictions on the employment of foreigners. The British Medical Association, for instance, has secured the provision that even the most highly qualified doctors may not practise in England without first spending two years studying at an English university. The present situation is, more or less, that it is virtually impossible for foreigners to enter the country to work except in a very few occupations.

Of course, one of the reasons why private interests succeed in persuading the public to restrict immigration is that they can play on popular emotions. Many people believe that it is racially "dangerous" to have people of "foreign blood" settling, and perhaps intermarrying in their country. History lends little support to this view, but it is the reason why, for instance, Australia restricts the immigration of Japanese, and some people in England would like to prohibit the immigration of Jews. We cannot enter into these questions in a textbook on economics, but we shall have to refer to them again when discussing the political framework of international relations.



## THE CAUSES OF WAR

Lastly we come to war. The causes of war are not all economic—indeed on a nice balance of economic considerations hardly any war would ever be fought. For war and preparation for war is a very expensive business; a great modern nation may spend two or three hundred million pounds a year in peace time on its war machine, and thousands of millions in a major war, not counting the loss of life and the physical and mental suffering involved. No nation which counted all the costs would freely commit an act of aggression purely for economic reasons.

Why then is there war? One reason is that powerful individuals or groups are sometimes able to drag a nation to war to advance their private interests. A group may be seeking to protect its foreign investments, to receive new trading concessions, to exploit the peoples of conquered lands, or just to make money by selling munitions. A king or fuehrer may itch to rule over wide areas and to know that millions bow the knee at his name. A truly democratic country would never let itself be dragged into war to serve these paltry private ends. But true democracy is seldom found; the public is often fooled by powerful interests, and when its emotions are stirred by patriotic slogans and appeals to national pride or racial superiority, it may well consent to give its youth and resources to the conquest of new territory.

Apart from these private gains, and apart from emotional pride in its conquest, what can a nation, as a whole, hope to gain from aggression? There

are two possible cases to be considered. First, if the two countries have been trading freely before, mere conquest will bring no gain unless the conquering nation proceeds deliberately to exploit the conquered. This it may do in many ways. It may levy tribute upon the people directly, in money or in kind; or indirectly, by compelling them to buy expensive goods from the conqueror instead of cheaper supplies elsewhere, or forcing them to use his worthless currency. It may take their lands, and make them labourers, or by prohibiting them from engaging in the more lucrative occupations and professions, may force them to be hewers of wood and drawers of water. In the other case, a country may feel itself compelled to go to war not to conquer and exploit, but merely to remove barriers which have been placed in the way of its trade. As we have seen earlier in this chapter, when one country plays about with its currency, or imposes tariffs or restrictions on migration it impoverishes others, and these others may feel that they have no alternative but to make war in order to remove the restrictions. Thus the reason the Americans gave for making war on Japan in 1854 was that the Japanese were refusing to trade.

The "colonial problem" illustrates both these points very well. Most imperial powers seek to benefit from their colonies partly by exploiting the indigenous inhabitants, and partly by excluding other Europeans. They impose a "colour bar" policy, reserving certain occupations to white men, and sometimes arbitrarily seizing the land of the inhabitants and using it for European settlement, preventing the coloured population from growing

crops grown by Europeans, imposing special taxes upon them to pay for European education, and directly or indirectly compelling them to work for Europeans at low rates of wages. This policy of exploitation is all the less excusable because the colonial people, being in general unskilled in the industrial arts, have standards of living much lower than those of the imperial powers who govern them, and are in need of subsidy and assistance rather than exploitation. At the same time most imperial powers impose restrictions on the trade of other countries with their colonies, thus giving a subsidy to their own producers at the expense both of the colonials and of rival European traders. Great Britain, for instance, pursued a policy of free trade in her colonies until 1933, but in that year she abandoned it in the interest of her own manufacturers. It is this sort of colonial policy which may cause friction between the nations.

The "minorities problem" also contains the same elements. If minorities were allowed equal economic and other opportunities they would have little cause for complaint. When, however, such equality is denied, so that the majority may exploit them, war may easily ensue.

#### INTERNATIONAL GOVERNMENT

But to catalogue in this way the reasons why one country may be tempted to make war on another is just like cataloguing the reasons why one individual may wish to rob another or to reduce him to slavery. Assault and robbery within the community are reduced to a minimum by social forces—particu-

larly by moral education and by the organization of law and order—and it is only because these same forces are scarcely operative in the relations between one country and another that the desire to exploit breaks out so frequently into war. Let us elaborate this further.

Take, first, moral education. Every schoolboy is taught that it is wrong to rob one's neighbour or to seek to enslave him. But in many countries he is seldom taught that it is similarly wrong for his country to seek to impose its will on others or to benefit at their expense. On the contrary, he is often filled up with doctrines of racial superiority, and introduced with pride to the story of the means by which his country extended its rule over foreign lands. In consequence, men have not quite the same high code of morality in dealing with foreigners and weaker nations that they have in relations with their compatriots. Of late there has been some improvement; when Italy moved into North Africa in 1935 there was a worldwide horror which found no parallel when Britain moved into West Africa fifty years before. But until national and racial pride and prejudices have disappeared, countries will still consider themselves entitled to conquer and exploit new territory.

When the right spirit of international co-operation prevails it will become possible to tackle the second problem—the organization of international law and order. Why do not individuals make war freely on each other? Apart from moral education, it is first because they are not allowed to carry many weapons, secondly, because there is a police-force to restrain them from violence, and, thirdly, because they know

that they can have grievances redressed either by impartial courts or through Parliament. No such conditions are found in the international field. Each nation can arm as heavily as it likes; there is no international police-force to put a swift stop to violence; and the international court (at the Hague) and Parliament (the League of Nations) have no power to enforce their decisions. If, therefore, international order is to be organized, nations must give up their sovereignty. They must become like individuals subject to control by a central government and international police-force, and not be allowed to have their own national military forces. Until the peoples of the world are willing to accept such a system, war will be their constant companion.

At the end of the last war a preliminary attempt on these lines was made with the establishment of the League of Nations. But the League was a parliament with few powers. It could not prevent nations from manipulating their currencies, imposing tariffs, restricting migration, or otherwise dislocating international prosperity. Nations could exploit their minorities or make war on their neighbours without its presenting effective resistance. It was not so much a parliament as a pulpit which nations might respect or ignore as they pleased. Despite its influence, aggressors grew gradually bolder and bolder, until to-day we are once more in the midst of major wars.

When peace returns mankind will have another chance to build a firm international structure. Even such a small beginning as a federation of Europe, modelled on the federal structure of the United States of America, would do much to reduce the

incidence of war. Dare we hope that when the time comes, the conquerors will seek not to exact vengeance and to crush the conquered, but to create a new structure based on equality of economic and political opportunity and on the federal control of armaments and authority, so that the desire of the common peoples of the world for permanent peace may have some chance of realization?

There is room for argument as to the exact framework of such a federation; we cannot go into this in an economics textbook. There is also room for argument as to the exact powers which such a government should have in the economic sphere. Should it, as in the United States of America, be the sole tariff-making authority and the sole authority in monetary matters? If we could put an end to the power of separate national governments to interfere with international trade, we should certainly have struck a great blow for economic progress. But the speed with which we can hope to progress to such an ideal will depend above all upon the attitude of the public to co-operation with other nations, and this no man can foretell.

#### SUGGESTIONS FOR FURTHER READING

The working of the foreign exchanges is very well treated in Clare and Crump: *A B C of the Foreign Exchanges*, and the case for and against tariffs in Beveridge: *Tariffs, the Case Examined*. On the breakdown of the Gold Standard consult Robbins: *The Great Depression*; on immigration, Angell and Buxton: *You and the Refugee*; and on war, Manning: *Peaceful Change, an International Problem*, and the writings of Sir Norman Angell and Mr. H. G. Wells.

## CHAPTER IV

### UNEMPLOYMENT

THE last of the general problems with which we must concern ourselves is that of unemployment. Why is it that so many people who want work cannot get it, and what can be done to secure that as many as possible of the community's resources be utilized, in order to avoid waste through idleness and unemployment?

#### CAUSES OF UNEMPLOYMENT

Some unemployment is caused by people leaving one job and tramping round in search of a more congenial one. This does not account for very much unemployment, and few people would think it desirable to take steps to prevent it, though indeed till quite recently in Soviet Russia it was treated as a serious criminal offence, and is so even to-day in many colonies.

Yet another cause of unemployment is the seasonal fluctuations in the demand and supply of some commodities. Thus there is a much greater demand for the services of agricultural workers and builders in summer than in winter, and a greater need for coalminers in winter than in summer. Again, the approach of the Christmas season brings with it an increase of employment which slacks off

immediately afterwards. Seasonal fluctuations do account for a fair amount of unemployment, but there is no need to regard such unemployment as calamitous since it can easily be foreseen, and is taken into account by workers before they decide to enter these industries at the prevailing rates of wages, instead of entering others where employment is regular throughout the year. It is difficult to calculate these matters exactly, but it is estimated that at any moment somewhere between 5 per cent and 10 per cent of the occupied population is unemployed on account of seasonal fluctuations or of shifting from one job to another. Some indication of the numbers involved can be seen in the following table which classifies the people who applied for unemployment benefit or assistance in September 1936, according to the length of time for which they had then been unemployed:

<i>Duration of Unemployment</i>	<i>Number of Applicants</i>
Less than 3 months .. ..	755,425
More than 3 but less than 6 months ..	123,625
"    "    6 "    "    "    9 "    "	78,733
"    "    9 "    "    "    12 "    "	56,507
More than 12 months .. ..	324,902
<b>TOTAL</b>	<b>1,339,192</b>

(From a table published by Sir William Beveridge in "An analysis of Unemployment," an article in *Economica* for 1937.)

From this table it will be seen that more than half the unemployed are out of work for less than three months at a time.



Another cause of unemployment is changes in consumers' demands. The decline of the demand for the product of one industry will lead to some unemployment there, but unless people are hoarding their money (we shall say something about this in a moment) it will be balanced by an increase of demand elsewhere and an increased offer of employment. For example, if people decide to have more wireless sets and fewer pianos, some unemployment will emerge in the piano trades, but there will be an increased demand for labour in the wireless trades. No problems would arise if the people left unemployed by the decrease of demand for pianos were shifted into the wireless industries where demand has increased, but this may be difficult. A major part of unemployment is due to the obstacles in the way of transferring labour from one industry to another.

#### OBSTACLES TO TRANSFERENCE

The first difficulty is that such transfers take time. Many countries have sought to reduce the time involved by setting up "Employment Exchanges" at which both workers seeking employment and entrepreneurs in need of labour are asked to register, so that they can be brought together with the minimum of delay. The same sort of purpose is served by advertisements in the Press, and by the private exchanges run by some trade unions and by private persons.

A second difficulty is that there may be some distance between the place where there is unemployment and the place where there is a shortage of

labour. This has been one of the major problems of Great Britain in the last twenty years. Unemployment has been concentrated in certain "depressed areas" in the north-east, the north-west and parts of Scotland and Wales, while industry has been expanding in the Midlands and south. In such cases either the workers must migrate to the expanding areas or industry must migrate to the depressed areas. But there are obstacles in the way of both solutions. Entrepreneurs, in deciding where to establish new industries, have to take account of many factors, and in general they have felt that the areas most suitable for their new industries have been the Midlands and the south. It would be possible for the state to try to compel them to set up their works in the depressed areas, but though many people have put forward this idea, the government has not so far accepted it. It did, however, in 1934, appoint four "Special Area Commissioners," part of whose function it was to try to tempt industrialists to set up in these areas; and in 1936 it further agreed to give some assistance to a company, the "Special Areas Reconstruction Association Limited," which was formed, with private funds, to develop "trading estates," i.e., attractive industrial sites. All this has had some effect on unemployment in these areas, but its contribution cannot be regarded as very significant. Apparently the government has accepted the view that such artificial stimuli can only result in the localization of industry in areas which are not the most suitable. Meanwhile a Royal Commission has been appointed to consider the whole question, and its report will doubtless be available by the time this book is published.

In addition to what it has done to stimulate private investment, the government has also spent some money on public works in these areas, in order to reduce unemployment. The principal bodies through which this has been done have been the "Unemployment Grants Committee," set up in 1920, and, strangely enough, discontinued in 1931, just when unemployment was at its height; and the Ministry of Transport, which has contributed towards the cost of building roads and bridges. This expenditure has had some effect, but cannot, of course, be regarded as a permanent cure for unemployment.

The other solution of this problem is for labour to migrate to the places where new industries are expanding. This has already occurred to a considerable extent, hundreds of thousands having found their way into the Midlands and south in the last twenty years. From the economic point of view it is the better solution, though of course strategic reasons, to which great importance is attached in these days, may make it less desirable. But migration too has its difficulties. For one thing, not all workers can afford the necessary travelling expenses. This, however, is not a great difficulty, for it can be overcome by using public funds to help to pay some of the cost of migration. Thus in 1928 the British government set up an "Industrial Transference Board," part of whose task it is to contribute towards the expenses of workers desiring to migrate. Another difficulty is psychological. It is hard to leave one's home and family, and in areas where large-scale migration is taking place, the general atmosphere of desertion causes the sentimental part

of our nature to raise a great outcry, like Goldsmith, against the "Deserted Village." Yet it was that very desertion of villages which tore the heart of Goldsmith, that was to lead to the redistribution of the population of Great Britain and the phenomenal rise in the standard of living in the nineteenth century.

Yet another difficulty in the way of transferring labour is occupational. The type of labour which has become unemployed may not be just the sort which is required in the expanding industries. It is difficult, for instance, to convert an old coalminer into an electrical mechanic. This accounts for a high percentage of the unemployment among older workers, and raises a serious problem. Such people have become "unemployable" in the sense that they are not capable of producing those things which the community really wants. They have to be maintained by the state, but instead of simply keeping them on the dole, it is probably best to create special work for them. The problem of the younger workers is not so difficult because they are more easily adaptable. Since 1918 there have been voluntary training centres at which the unemployed can learn new trades, and since 1929 attendance at instructional centres has been made compulsory on juveniles in receipt of unemployment relief, in cases where the authority thinks such attendance would be desirable.

Training, however, is not by any means the most important source of trouble. A decline in the demand for the services of a particular grade of labour, whether due to a decline in the demand for its product, or to an invention, means that the community does not place so high a value on its

services, and the workers will now be offered lower wages. If trade unions stick out for the old wage, unemployment must result. Again, when some of the workers try to get employment in other industries, they may find trade union barriers up against them there too—apprenticeship regulations, for instance, or an insistence on high wages. Such barriers can only reduce the rate at which the expanding industries are able to absorb displaced labour, and must lead to unemployment.

All these factors help to explain why unemployment has been so high in Great Britain ever since the War of 1914-18—never less than 10 per cent of the insured population. After the War there were changes in the supply and demand for various products. The end of the War meant of course that the country was better off, but it meant also a permanent decline of the demand for the services of some groups of workers, especially those associated with fighting the War—soldiers, iron and steel workers, coalminers, seamen, and so on. This in turn meant that there had to be a more than proportionate fall in the wages of such workers, and a re-direction of labour into other industries; and it is significant that unemployment since the War has been greatest in industries which had to be expanded during the War (coal, shipbuilding, iron and steel) or which lost their markets to foreign competitors as a result of the War (cotton). Added to these maladjustments originating from the War was the unfortunate coincidence of the simultaneous exhaustion in parts of Wales and Durham of seams of coal on which the population had depended for a living. And, finally, from 1925-31 British exports suffered

as we have seen in Chapter III, from an over-valuation of the pound which could only have been redressed either by lowering the structure of prices and wages (and this was bitterly resisted by the trade unions) or by adopting a lower parity on the Gold Standard (this being opposed by those who benefited from the cheapness of foreign monies). Economic systems work most smoothly when the adjustments to be made are small; the coincidence of three great sources of maladjustment put a great strain on the system's capacity for adjustment, and unemployment kept at a high figure. All the obstacles to transference came into play with a vengeance. The industries affected were located in different areas, so that cross-country migration was called for on a large scale. Then there were the difficulties associated with training the unemployed for new occupations. And, finally, there was the policy of some trade unions in the expanding industries which, by keeping wages up and by other restrictions, reduced the capacity of these industries to absorb the unemployed. The situation was clearly a difficult one, requiring bold measures to facilitate transference. Some measures were actually adopted, as we have seen, but on a scale much too small for the problems in hand, with the consequence that the necessary transference has been slow and painful.

#### CYCLICAL FLUCTUATIONS

So far the type of unemployment we have discussed has been sectional, a slackened demand for labour in one industry being paralleled by an increased demand elsewhere. Its cause has been

difficulties of transference and it has been localized in a few industries. But it is clear that not all unemployment is of this type; sometimes the level of activity seems to recede everywhere simultaneously, so that unemployment emerges everywhere at the same time. How does this happen?

The phenomenon is one in which all firms seem to be making losses at the same time. But since the costs of production are nothing but the sums paid out to the public as wages, rents, dividends and so on, if the public spent all its money it would all come back to the firms and they could not possibly all make losses simultaneously, since the total sum received from sales by all firms put together, would exactly equal the total sums they had paid out as costs. Of course, some firms might make losses, but others would make corresponding profits. If then general losses are experienced this can only be because the total amount spent by the public is not as great as the amount it received in wages, rents, and so on. Why should this happen?

Some people have suggested that the fact that the public saves some of its income makes total spending less than total costs. But this is not necessarily so. Money saved is usually invested—put into savings banks, or used to buy shares or insurance policies or something like that. The savings institutions usually pass it on to someone who uses it to buy machinery, or factory buildings or some other equipment. So that as long as the link between savings and industry is unbroken, the mere fact that people save does not lead to disequilibrium. Savings are just another form of spending, being money used to buy not bread and shoes but machines and factories.



Consequently, we must distinguish carefully between savings which are spent and those which are not spent, being, for example, buried in the ground or left lying idle as a balance at the bank. If people decide to increase their "hoards" of money this will reduce the amount going back into circulation, and some firms will make losses not counterbalanced by profits elsewhere. But why should people increase their "hoards"? In general, there is little incentive to do so. Money held idle yields no return, while money invested in shares, or in savings banks, or directly in industry does earn something. If we can lay our fingers on the special causes which lead people suddenly to hold idle funds we shall have found the causes of general unemployment. Actually there are many possible causes; we can only deal here with a few of them.

One such special cause is a general loss of business confidence. For example, if people expect war to begin in the near future they may become reluctant to part with money. If it happens at the same time that the government is spending new money on building armaments the effect of this may be counteracted; but otherwise the sudden hoarding would cause some firms to make losses. Again, if people are distrustful of the government in power they may decide to hoard. A good example of this was the American situation in 1937-39; many business men disliked what they regarded as the advanced views of President Roosevelt, and feeling that they did not know what he was going to do next were reluctant to make commitments. Such general unwillingness to invest may cause a breakdown, or if it occurs in the course of a depression, may delay recovery.



A much more important cause of sudden hoarding arises from the tendency of economic development to go in jerks. Some new invention or project comes before the public mind which offers great prospects for investment. It may be the development of a railway system, of motor traffic, of electric power, or some other type of capital construction. While it lasts it acts as a great spur to business confidence; usually at these times the banks lend money freely and the economy goes ahead at feverish speed. In the general atmosphere of confidence many investments are made which are not really justified by the state of demand. Eventually the undertaking which first gave rise to the boom is completed; the railway has been built, the electric power-plants are at work. New projects doubtless exist awaiting exploitation, but it takes time to draw up the plans for them; also it is theoretically possible that the only projects available offer such poor prospects that people prefer to keep their money idle rather than invest in them, though we do not know whether this really happens in practice. Anyway, in the interval while the new projects are prepared, the men employed on the old ones become unemployed, their unemployment reacting unfavourably on the industries which cater for their wants, and thus spreading its evil influence. Seeing this, the banks, which have been lending money freely, begin to get anxious about some of their customers the folly of whose investments is beginning to be obvious. They decide to pause in their lending, and even to call in some loans. Thus business men are forced to reconsider their investments, only to discover, now that the wave of optimism is past, that prospects are not as great as

they had hoped. Pessimism succeeds optimism; creditors call in their loans; retrenchments are made; unemployment mounts; hoarding increases. The system becomes depressed until some new invention or other prospect buoys up confidence once more and restores its energy.

#### THE GREAT DEPRESSION

The world slump which began in 1929 seems to have been of this type. The Great War left the world with much need for construction and reconstruction. In America, 1921-28 saw a great building boom to make up for the shortage of housing which had developed during the Great War, as men and materials were more urgently required for military purposes. In 1921-25 there was great activity in residential building, followed in 1925-28 by great factory construction. Another factor contributing to the boom of the 'twenties was the development of the automobile industry, and an accompanying road construction. A third factor was the reconstruction of European industry, which had deteriorated during the War; German industry was completely reorganized and re-equipped, and industrialization proceeded apace in France. Large sums of money flowed to Europe from America, and were used mainly to buy materials for reconstruction purposes. This was a demand which could not last for ever. Finally, the period was one of rapid credit expansion. It will be remembered from Chapter III that England returned to the Gold Standard at a rate of exchange which made the level of British prices too high in comparison with foreign prices, and that in

consequence of this gold tended to flow from England to America and France. In America the banks tried to raise the level of prices so as not to embarrass England, and they did this by lending money freely for a time, until they themselves became alarmed at the excessive optimism which easy credit was inspiring. All these factors combined to make the twenties a period of great reconstruction, but as the reconstruction came to an end, the pace of development began to slow down and confidence was undermined.

Building activity in America began to decline in 1928, and as unemployment increased in this industry it affected adversely industries making goods for sale to builders. About the same time the flow of loans to Europe began to decline. Now if the builders and those who had been employed by the foreign loans could have been set right away on to new projects, no slump would have ensued. But, as we have seen, there is always a time lag between the completion of old plans and the commencement of new ones; and besides some unwise investments were due for liquidation. Anyway, some prices began to decline early in 1929 and eventually in August stock exchange prices came down with a rush. Many financiers and banks were involved, and an atmosphere of depression spread over the whole world; prices everywhere fell as business men re-examined their original estimates more conservatively, and the slump grew cumulatively worse.

What made the 1929 slump more severe than previous ones was the presence of an abnormally unstable element, namely, weak financial systems in Europe. Inflation during and after the War had

severely strained many European banking systems, and financial stability had only been restored on the basis of loans from England, France and America, mostly loans subject to recall at short notice. The onset of the slump weakened the position of these countries, especially as one country after another, following the lead of America in 1930, put up high tariffs, for the tariffs by reducing international trade simply made them all poorer. Seeing this, investors lost confidence, and began to recall some of their loans. Austria was the first country which collapsed under the strain, its most important banks having to close in May 1931 as they could not repay the sums they had borrowed. This created further panic; a rush was made on the German banks, which similarly had to declare their inability to pay. Then the rush spread to the British banks, which also owed much to foreign creditors, and were now unable to get their own funds back from European debtors; for a while they paid in gold, and arranged further credits (they borrowed from Peter to pay Paul), but eventually the strain became too great, and in October 1931 Great Britain abandoned the Gold Standard, thereby refusing to pay anything at the old rates of exchange. This final collapse, due almost entirely to an international loss of confidence, made the situation much worse; for it discouraged people from buying or making any business commitments which they could possibly avoid, and encouraged governments to embark upon a war of tariffs which strangled international trade; it was thus probably the major factor responsible for the prolongation of the slump.

## REMEDIES FOR DEPRESSION

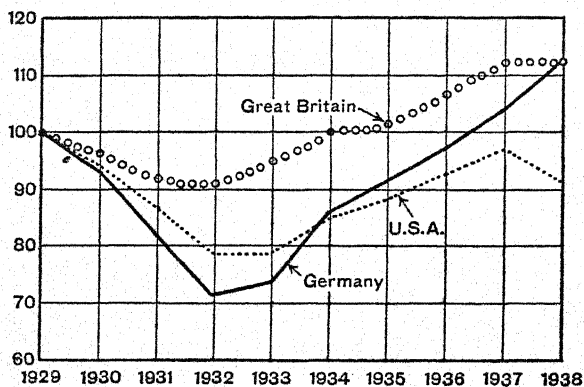
What remedies could usefully be applied in this situation? The first was to restore confidence in the banking systems, and this was done by arranging for banks in the strong countries to assist those in the weak ones. The accession of new governments to power, the National government in Britain in 1931, the Hitler régime in Germany in 1933, and the Roosevelt régime in America in the same year, also acted as psychological tonics; whatever the merits of their respective policies, their supporters felt at that time that these were men who were determined to "do something," and this itself tended to strengthen confidence and promote activity. A permanent restoration of business confidence, however, could only be secured by some improvement of the prospects for new investment.

We need not deal at any length with the measures put forward for curing unemployment in other ways. There were measures which proposed to cure unemployment without bringing about any real increase in the national income. Thus, in Germany, some women were discharged from industry, their jobs being given to men, and of course to the extent to which such women ceased to be considered unemployed the unemployment statistics showed a net decrease without any real increase in employment. Another plan adopted to a small extent in the same country was to discourage the use of machinery so that there was more work for human labour to do, but no more fruits to show for that labour. In America, France and elsewhere, hours of labour were

reduced and work shared out among more people, so that the number on the payrolls showed an increase, without any corresponding increase in work done. Whatever the merits of such devices as temporary makeshifts, they could not be regarded as permanent solutions.

The more valuable proposals centred round plans for increasing the incentive to invest. (i) Some people thought that an increase in wages, by putting more money into the hands of the workers, would provide such an incentive. The plan was actually tried in America and France, but as the increase in wages raised costs to the same extent as it increased the sums received by entrepreneurs, there was no real incentive to invest more, so the experiments failed. (ii) A more successful method of increasing purchasing power would have been to tax the rich who were suspected of hoarding money, and to pay the money thus released to the workers who were more likely to spend it; though the snag here, of course, would be that such taxation might make the rich even more reluctant to spend what was left to them. (iii) Other people suggested a general increase in prices, as the factor which struck them most obviously was the low level to which most prices had fallen during the slump. A general increase in prices at the expense of wages might have promoted recovery if it could have been maintained, but a general increase in prices and wages together would be ineffective, as the margin of profit would be unchanged, and this was soon discovered in America, where the experiment was made. (iv) Another suggestion was that the government should take steps to make money available on easy terms,

and even create money to replace what was being hoarded. This policy was adopted with varying success in a number of countries, notably Germany, Britain and Sweden, and with rather less success in America. (v) And, finally, it was suggested that



AVERAGE NUMBER EMPLOYED IN EACH YEAR SHOWN AS A PERCENTAGE OF AVERAGE NUMBER EMPLOYED IN 1929

while entrepreneurs were waiting for the opportunity to start on new projects, the government might step in with projects of its own. This policy met with varying success. It was completely successful in Soviet Russia, which was able to avoid unemployment during the depression as its government created the necessary money and pushed ahead with schemes for industrializing the country. It was also successful in Germany after 1932, when work on public projects, not least the building of armaments, absorbed large numbers. But it was not so success-



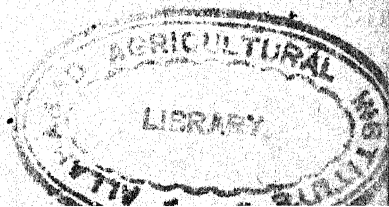
ful in the United States of America where, for special reasons which we shall consider in a later chapter, private entrepreneurs proved reluctant to take over from the government in due course. The public works policy was not tried to any extent in Great Britain, but as can be seen from the accompanying diagram, this country did quite as well as Germany and much better than the United States, even without it. The reason for this is that there were considerable arrears of housing to be made up, and private entrepreneurs got on with the job.

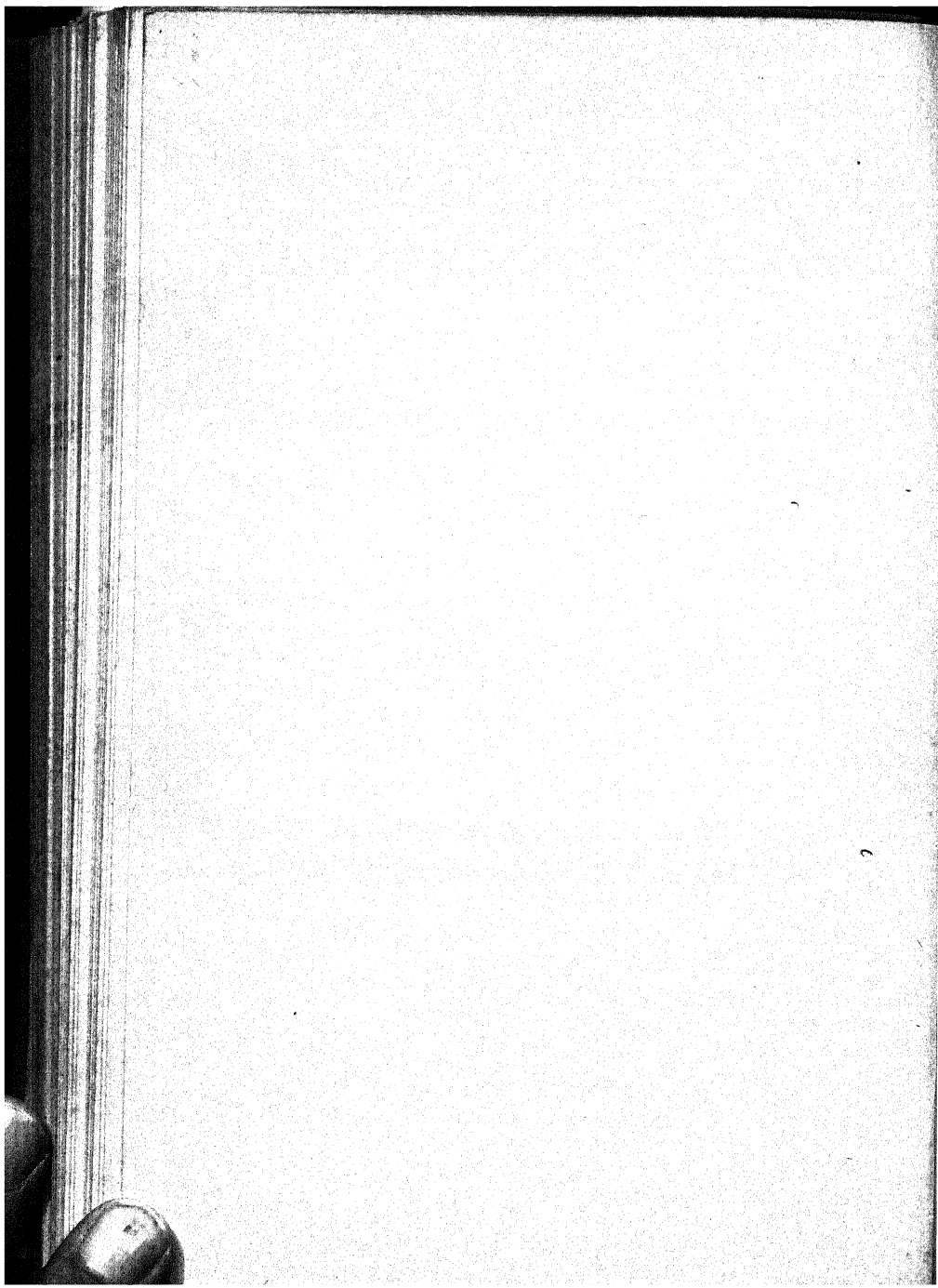
It is unlikely that any country can completely iron out all fluctuations in the level of employment, if only because of the necessary time lag in passing from one project to another. What can be done, however, is to reduce the time lag by keeping some projects continually in cold storage. This is undoubtedly a field in which governments can be very useful; for even without going as far as Soviet Russia and taking over complete control of industry a government can have all the plans for various public projects carefully worked out beforehand, and bring them out as private projects are completed and the level of activity begins to recede. At the same time it can try to prevent the excesses of the boom from occurring by keeping a check on the issue of credit by the banks. Governments are still groping towards the technique necessary for control, but we have got so far in understanding the problems involved that future fluctuations need no longer hold for us the terrors of the past.



## SUGGESTIONS FOR FURTHER READING

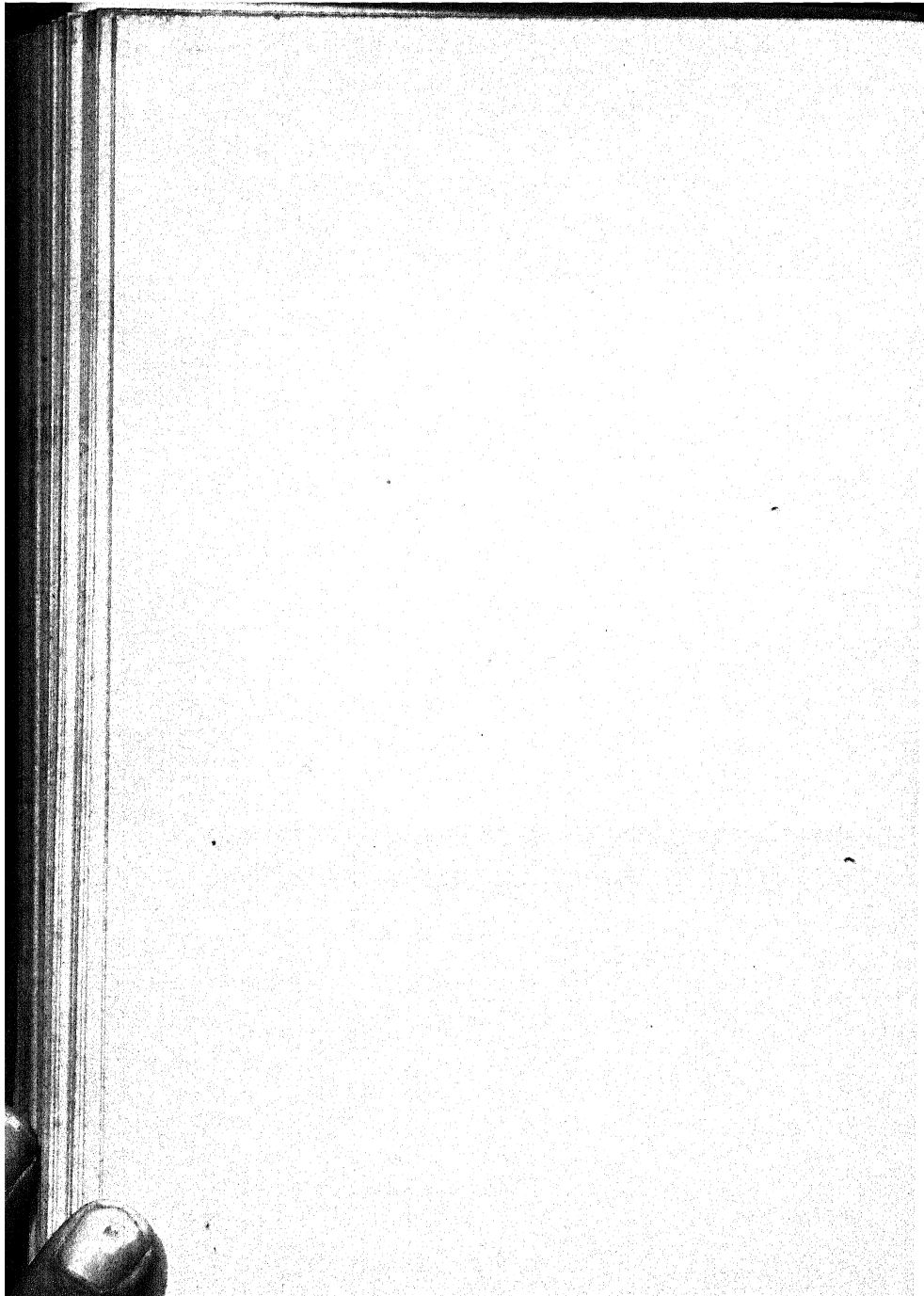
On frictional unemployment consult Beveridge: *Unemployment*; Davison: *Unemployment Policies* and *The Unemployed*; Lubin and Hill: *The British Attack on Unemployment*; and Political and Economic Planning: *The Location of Industry*. For Trade Cycle theory, see Harberler: *Prosperity and Depression*; and Robbins: *The Great Depression*.





PART II

THE SOLUTIONS ADOPTED ABROAD



## CHAPTER V

### RUSSIA

#### HISTORICAL BACKGROUND

AT the outbreak of the Great War in 1914 Russia was the most backward of the great European states. Its hundred millions of peasants carried the weight of a despotic Czar, a corrupt landowning nobility and a stagnant church. Emancipated in 1861, many years after the peasants of Western Europe had thrown off the yoke of serfdom, they were still striving for economic security, in contest with the aristocracy. Revolution in 1905 and countless other local revolts had wrung some concessions from the government and the nobility, but the lot of the peasant continued hard. The industrialization of the country had begun very late in the nineteenth century, and though it was making rapid progress, industrial output was still relatively small. Urban workers were, in consequence, few in number, and their trade unions, illegal until 1905, were still regarded with hostility by the authorities. The growing class of business men resented the despotism of the Czar and his advisers, and looked with envy to western states where business men were free and dominant in society. With corruption, incompetence and ruthless despotism above, and discontent below, the stage was set for revolution.

The war proved too much for the Czar's administration. Transport was inadequate, and the badly-equipped soldiers suffered horribly in the cold Russian winters, besides being no match for the German army. Discontent grew both in the army and at home, where the hardships imposed by the war were reinforced by news of hardship and reverses at the front. Eventually the Czar's government was overthrown in February 1917. The new government was liberal and somewhat radical in character, and given time, would have set itself to improving the conditions of the workers and the peasants. It failed, however, because it decided to continue the war, with which the nation was thoroughly disgusted. "Peace and Land" became the slogans, and when the Bolshevik party came forward in October offering to satisfy these demands it had little trouble in disposing of the government, and assumed power.

The Bolshevik party (it later changed its name to "Communist" party) was one of the two sections of the Social Democratic party, the party of the urban workers, of which the other was the "Menshevik" party. It was led by a group of intellectuals amongst whom the most outstanding was Lenin. Its aim was the abolition of private property, nationalization of land and factories, and creation of an equalitarian society. It was not the only party committed to this programme, but it differed from the others in being a closely disciplined body, determined to maintain itself in power at all costs. Its dictatorial methods and crude fanaticism had alienated it from all other political parties with socialist and equalitarian aims, and even to-day, though there are Communist parties

in most countries of the world, they have, for these very reasons, still failed to win the confidence of any significant proportion of the working or peasant classes. Russia in 1917, however, was a disintegrating society; Lenin seized his chance, and by means of methods in some ways no less despotic than those of the Czar, his party has succeeded in remaining in power to this day.

It is impossible to understand Russian economic development properly without realizing from the very start that the government is a dictatorship able to impose its will on the people without any prospect of effective opposition. Communists describe the situation as being "the dictatorship of the proletariat"; others as the "dictatorship over the proletariat," and there is substance in both views. Theoretically, Russia is ruled by its workers and peasants; there is a great show of democracy in election to the soviets (local authorities), parliament, the trade unions, and the co-operative organizations. But, in fact, the Communist Party is master of the country. As the government controls the press, radio and all other organs of public opinion; as no other political party is allowed, and no criticism of any decision made by the party congress; and as the government maintains in the "G.P.U." one of the most efficient, most powerful, and most ruthless secret police services in the world, the Communist party succeeds very easily in maintaining its domination. Moreover, within the party itself, Stalin, who worked his way to power after the death of Lenin, is effectively dictator. Unlike Hitler and Mussolini, he is a silent man, not given to strutting about in uniforms and haranguing the people; yet no one,

however eminent in the party, can oppose his will and live. The constitution of the party provides for the periodical examination of every member, when those who have tended to be too critical may be expelled. Besides this, the world has been startled from time to time by the trial and execution of most of the old Communists of any independence and reputation who showed any inclination to challenge Stalin's position, until to-day there is hardly any one of worldwide distinction left in the party. Yet it would be wrong to believe that the government maintains itself entirely by oppression. On the contrary, if only as the result of propaganda, it is popular with a large proportion of the urban workers, and is slowly beginning to be recognized by the peasants. Like the régime of Hitler in Germany, it is a popular but ruthless dictatorship.

#### COMMUNIST ECONOMICS

None of the leaders of the party had any idea when they came into power in 1917 how they proposed to run the socialist society. Communist literature had been concerned almost exclusively with denouncing propertied society, and working out a technique for overthrowing it. We have seen in Part I of this book that the problem whether property should be socialized or not is only one of many, and that the solution adopted for this problem does not vitally affect the considerations relevant in solving the others. This the Communist party firmly disbelieved; it was convinced that all the principles which previous societies had set out for regulating economic life were "*bourgeois* economics," designed



solely to grind the faces of the poor. The stage was thus set for great experiments in a way that only dictatorships can hope to achieve. In the last twenty years one solution after another has been tried, only to be rejected in many cases in favour of solutions already in practice in other countries. Though it would be the last to admit it, the Communist government is gradually and painfully learning what it has hitherto dubbed "*bourgeois* economics," and coming to realize that the nationalization of property, while it changes profoundly the distribution of income and power within a society, leaves most of the other economic problems unaffected. For the student of economics, a study of the economic history of Soviet Russia provides an excellent grounding in the principles of economic theory.

#### WORKERS' CONTROL

The idea of handing over each factory to the workers engaged in it and allowing them to run it as they please has appealed to philosophers of many political shades. The first experiment was made on these lines. A decree of November 1917, immediately after the Bolshevik revolution, gave the workers in each factory the right to control it through their elected representatives. This was done even before general nationalization, which was not put into effect until June 1918. It proved unsuccessful. As Lenin himself said: "Workers' delegations used to come to me with complaints against the factory owners. I always said to them, 'You want your factory nationalized: well and good. We have the decree ready. But tell me. Can you take the organization

into your own hands? Have you gone into matters? Do you know how and what you produce? And do you know the relations between your production and the Russian and international market?' And inevitably it transpired that they knew nothing. There was nothing written about such matters in the Bolshevik textbooks, or even in those of the Mensheviks." Possibly with time these difficulties might have been overcome, but the policy was soon abandoned. A decree of June 1918 laid down that managers were to be appointed by the government, and that the workers were to respect their authority, and this decision has never been reversed.

Nevertheless, though the worker has no say in appointing the management, and strict discipline is enforced, factory workers are permitted in Russia, as in Great Britain, to negotiate with the management on various points. In Britain this is done through the works councils which exist in most big factories. In Russia it is done through the "triangle," a committee in each factory consisting of representatives of the trade unions, the management, and the party, which discusses questions affecting the welfare of the workers. But as the trade unions are dominated by the Communist party, which also controls the government and the managers of the factories, it must not be too easily assumed that the ordinary non-political worker in Russia is able to exercise as much pressure on his management as is the worker in the vigorously independent trade unions of Great Britain or France.

“WAR COMMUNISM”

Simultaneously with the nationalization of the factories and the abandonment of workers' control, the civil war broke out, with Britain, France and other foreign powers intervening in the hope of dislodging the Communists. The war lasted two and a half years, till November 1920, absorbing all the efforts of the nation. Industry was put on a military basis; money ceased to function; the population was severely rationed; and the standard of living fell to a low level. The end of the civil war found economic life badly disorganized, and discontent mounting, especially among the peasantry. Nevertheless, many Communists welcomed the type of economic system which had been brought into being—the “dethronement” of money; the issue of ration-cards on a more or less equalitarian basis; and the highly centralized organization of industry on military lines. But the public had had enough of it; revolt spread even to the troops stationed at Kronstadt. Lenin, therefore, decided on a quick decentralization of control, involving the restoration of money, and since the government had not been able to arrange for the proper distribution of commodities he allowed private persons to enter into retail trade and even to become employers in light industry, while keeping most of the factories and transport and banking under socialist control.

This was not, however, the last experiment with rationing. Again in 1928 it was introduced, but in response to public dissatisfaction was withdrawn again in 1935. To-day it is accepted that it is more desirable to give the public its income in the form of

money and let it exercise its own choice. Many Communists used to be suspicious of money, regarding it as a *bourgeois* device for exploiting the poor, but they are now seeing it as a device which makes it easy for the public to express its preferences.

#### THE NEW ECONOMIC POLICY

Lenin's "New Economic Policy" was announced in 1921, and continued to operate until 1928. Under it the country made rapid progress. Production increased in the socialized factories, and retail trade in private hands. By 1928 total production was once more up to pre-war level, after having been halved during the civil war.

The government however was not satisfied. For one thing it objected to private shopkeeping on principle, and was determined to do away with the "Nepmen", as the private entrepreneurs were called. From about 1927 it gradually increased the number of state and co-operative shops; simultaneously it steadily increased taxation on private trade, and eventually, in 1929, imposed heavy restrictions on private trading which reduced it to insignificant proportions.

Secondly, it wished to experiment with "planning." We saw in Part I of this book that most countries solve the problem of deciding what is to be produced by allowing the public to spend its money freely, and encouraging producers to increase the output of goods for which the public is prepared to pay more than the cost of production. The Communist party could have adopted this solution, requiring its nationalized factories to produce those

commodities which yielded the highest wages, profits and other earnings. But it chose otherwise for three reasons. First, it held to the dogma that "production for profit" is a method of exploiting the poor, and inferior to production for use; the fallacy which we have already exposed in Chapter I. Secondly, its leaders had no intention of allowing the public freedom of choice; for they felt that it was necessary to put through a programme of social services and industrialization which the public would probably have rejected in favour of producing more goods for immediate consumption. Finally, the party underestimated the difficulties in planning from a central office what 160,000,000 people, scattered over one-sixth of the surface of the globe, should produce from day to day. Even the difficulties inherent in co-ordinating the work of a single enterprise, such as a department store with a few hundred employees, or a railway system, were not adequately realized. Just before the Bolshevik revolution, in August 1917, Lenin had written of the administration of the state, "Capitalist culture has created large-scale production, factories, railways, the postal service, telephones, etc., and on this basis the great majority of functions of the old state power have become so simplified and can be reduced to such simple operations of registration, filing and checking that they will be quite within the reach of every literate person." The statement which we quoted earlier from his speech on workers' control, and his adoption of the New Economic Policy, both suggest that before his death he had come to realize that the administration of the state or of industry raises problems which call for something more than

mere literacy, but the lesson had not as yet been learnt by his successors.

Accordingly it was decided in 1928 to run the economic system from the centre, requiring each establishment to work according to a general "plan." A central statistical office known as "Gosplan" had been established in 1923, and it was now made the central planning authority. As the planning phase has not yet passed, we should give a little attention to the way in which the system works.

#### CENTRAL PLANNING

Productive enterprises are of several types in Russia. First there are the establishments whose property belongs to the state; these are controlled either by the Federal government of the union, or by the governments of the constituent republics, or by local authorities. Most factories, mines and transport undertakings come within this category. Then there are the co-operative enterprises, whose property belongs to the members of the co-operative society. Agriculture is conducted mainly by such co-operative societies, called "collective farms," but there is also an insignificant handful of farms owned by the state. Some retail shops are run co-operatively, but most of the large departmental stores are owned by the state. Some of the smaller industrial concerns are also run on a co-operative basis, under the name of "artels." Finally, there are a large number of individual workers, such as tailors, cobblers, lawyers, peasants and others who work on their own account.

Every establishment, whether it be factory, shop

or transport undertaking, is required to draw up an annual estimate showing how much labour and raw materials it expects to use, and what it expects its output to be. In 1927 estimates for five years were called for, and incorporated in the "First Five-Year Plan," which ran from October 1928 to December 1932; and similar five-year estimates drawn up in 1932 formed the basis of the "Second Five-Year Plan," from January 1933 to December 1937. So many unforeseen things can happen in five years, however, that too much importance need not be, and is not attached to such estimates, except for purposes of propaganda. The really important figures are the estimates made annually, quarterly, and even in a few cases, monthly.

Now the making of estimates of this kind is not new; most big enterprises in Britain and America do it under the name of "budgetary control." The main purpose of budgetary control is to co-ordinate the activities of the many separate parts of a business in preparation for foreseeable changes, and to enable the management to check up on their efficiency, and this is also a principal purpose served by planning in Russia. What is different in Russia is twofold. First, estimates once made and approved have to be adhered to; industry is therefore put into the strait-jacket of uncertain guesses as to the future, and though some flexibility is allowed, the ability of enterprises to adjust themselves to changing conditions is naturally reduced. And, secondly, the method by which these estimates are co-ordinated is different. It is only natural that the estimates of so many thousands of different establishments should not necessarily be consistent with each other; for

example the engineering firms may in the aggregate be planning to use more steel than the steel firms are in the aggregate planning to produce, and so on. Outside Russia plans are co-ordinated in the market; where many firms are competing for a limited supply of labour or some raw material, those whose products the public prefers will be in a position to pay higher prices than those whose product is less preferable, and in this way supply and demand will tend to be equated in all markets, and resources to be allocated to those enterprises which can make the best use of them. But in Russia the equation of supply and demand is left to "Gosplan," which has to decide which enterprises shall have the available resources, and just what each enterprise shall be allowed to produce. How does it make these decisions?

The answer is that it does just what it thinks best, subject to the government's approval. If it thinks that the output of shoes should be expanded more than the output of furniture, or the number of new railways more than the number of new houses, so be it. Public discontent can make itself felt surreptitiously, but subject to this, the government is free to produce just what it thinks the people need or ought to have. And in particular it has used its power to impose two policies, a great increase in saving, and an extension of social services.

The industrialization of the country, decided in 1928, could have been carried out without hardship if the government had raised the necessary loans abroad. But Russian credit abroad was not very good, partly because the government had repudiated the loans made to its predecessors, and partly



because foreign nations distrusted the Communists. Hence industrialization meant that men and resources would have to be diverted to constructional work, not likely to yield fruits in the immediate future, and that in consequence the output of goods available for immediate consumption would have to decline. The public was called upon to pull in its belt for some years on a lowered standard of living, in the hope that production would increase in future years. It is unlikely that the public would have consented freely to the drastic increase in saving and decline of consumption which was involved, and there is reason to believe that it was partly as a result of public discontent that the government decided to provide for more consumption and less saving in the second five-year plan.

Was the Communist party justified in forcing such a heavy reduction of consumption upon the Russian people in the interests of the future? There can be no agreement on this question. Those who regard society as a laboratory for sociological experimentation will be certain that it was, while others who think more in terms of the human suffering involved, or of the value of freedom of choice, will be more sceptical of the Communist arguments. The main reasons for pressing the policy forward were a desire to show quick results, so as to convince the world that Communism was capable of a rapid rise in the standard of living; and a desire to make the country self-sufficient so as to be able to withstand any possible military attack. But in any case much of the saving and suffering were rendered fruitless. For one thing, the pace was forced too fast. The Russian worker lacked the technical

training to handle complicated machinery, and the peasant the ability to handle tractors. Consequently, the mortality of the new machinery was high, and much better results might have been achieved by going at a pace more suited to the state of technical education, and spending more money on education before investing in delicate machines. Moreover, the Communists suffered from a size mania, accepting it as axiomatic that the bigger a concern the more efficient it would be. Giant concerns were established, many of which proved too big to operate efficiently and smoothly, if only because the Russian managers lacked the necessary training and experience for running large concerns. (This principle of "*bourgeois* economics" has now been learnt, the new establishments tending to be rather smaller than those erected under the first five-year plan.) The government claims to have fulfilled the first plan to the extent of 93 per cent, but as these results are measured in roubles, and as the value of the rouble was much less in 1932 than in 1928, the claim has value only as propaganda. Independent estimates based on official statistics of output in physical terms show that in most cases production did not exceed 50 per cent to 60 per cent of the original "plan."

The other policy which the party wished to carry through was a rapid extension of social services. Here it was much more successful. When it came into power, the population was mainly illiterate; to-day, compulsory education has been established, and illiteracy is being conquered at an unprecedented rate. There has also been a great extension of facilities for secondary education and for technical and university training, open to students on the basis

not of family status but of educational merit. The policy is not, however, wholly altruistic; the educational system is used as a vast propaganda machine for turning children into atheists and enthusiastic supporters of the Communist party. The Russian has learnt to read and write, and acquired some technical knowledge, but every effort is made to prevent him from thinking independently on social or philosophical issues lest his conclusions should differ from established Communist dogma. Large sums have also been spent on public health. Child welfare clinics, maternity centres, and hospitals have sprung up throughout the country, and their services are available to all citizens free of charge or at low fees. A system of social insurances has also been built up, providing security in sickness, old age, or other time of need. When the party came to power Russia was very far behind other countries in the provision of social services; it is still backward in many respects, but the government has excited much admiration in foreign countries for the speed at which it has progressed.

Granted that the government desired to force through industrialization and an extension of the social services, this is no reason why in all the other fields of economic life it should have imposed its will upon the consuming public. In the last few years "Gosplan" has found itself subjected to increasing pressure from the retail organizations to extend the production of this or that commodity for which public demand is greatest. The retail organizations know what the public is prepared to pay, and by comparing prices with costs they can see what ought to be produced, so that to an increasing extent profit

is coming to determine what should be produced. To some extent, too, production is being decentralized. While the heavy industries are still strictly controlled by "Gosplan," light industry, instead of forcing its products upon the retail organizations, is more and more having to produce what they demand. "Gosplan" itself has been decentralized, authority passing more and more to the local branches established all over the country, so that local needs receive better attention. In addition, local authorities are allowed to set up factories to supply local demands, and they and the "artels" work mainly to order from the retailers. To this extent planning from the centre is disappearing. As yet the process has not gone very far, but it is clear that the Communist government is coming to realize that the market is a better guide to what the public wants than any central planning authority, and we need not be surprised if central planning gradually gives way to some "new economic policy." Centralized planning is not essential to socialism; it is a dictatorial encumbrance which, in its more rigid forms, can only appeal to those who believe that governments should be free to impose their will upon the public.

#### UNEMPLOYMENT

It is often claimed that centralized planning has made the emergence of unemployment impossible. Stated so baldly, the claim is ridiculous. There must always be a certain amount of unemployment in any system as a result of seasonal influences and of people shifting from one job to another in response to

changes in demand and supply. It is true that by abolishing unemployment relief in 1931 the government has virtually been able to compel every one to accept whatever job he is offered at whatever wage, or starve. But even this rather crude liquidation of one of the obstacles to the transference of labour has not abolished unemployment. There are no longer statistics recording it, but unemployment due to seasonal influences and immobility exists in Russia as elsewhere. What, however, of cyclical unemployment?

We saw in Chapter IV that cyclical unemployment is most adequately regarded as the time lag between one great advance in capital construction and another. Now if the Soviet government delayed its plans so that several projects came to an end together before new ones were ready to take their place unemployment would certainly emerge, and might provoke a severe slump. The advantage which the government derives from centralized planning is that all its projects are thought out beforehand and can therefore be synchronized easily. This is a real advantage, but it is not one of which central planning or socialism need have a monopoly. Even in a private-property society without central planning a government can prepare its plans for public works carefully and execute them so as to fit in with private capital construction. The Russian example is just one more proof of the success which can be achieved by governments in this field.

## INCENTIVES TO EFFICIENCY

No one is actually forced to work in Russia, except the millions of persons imprisoned for criticizing the régime (it has been estimated that there are more prisoners in Russia than in all the rest of Europe put together) and set to work on constructional projects. The main incentive to work is that no adult may eat unless he works. There is no unemployment insurance. No private person can receive income from renting out land, and though interest is paid on savings invested in the savings banks and in government loans, very few persons could receive enough from this source to keep them, especially as the inheritance of property has been virtually abolished by death duties which rise to as much as 90 per cent on the larger holdings. There remains however the problem of allocating labour between the many industries and occupations, and securing the maximum output from each worker.

"From each according to his ability and to each according to his needs" is an old Communist slogan. Many communists believed that it would be possible to establish a society in which earnings were divorced from the quantity and quality of one's work without affecting the incentive to hard work and efficiency. Throughout the 'twenties attempts were made to keep as near to this ideal as possible; wages were levelled up, and the salaries of technicians and managers reduced to a level not much greater than those of the ordinary workers. It was gradually realized, however, that this tended to destroy the incentives to work harder and to improve one's

qualifications; with the decision to press forward with industrialization from 1928 the problem of incentive became urgent.

To some extent the government depends on non-monetary incentives to encourage the worker to be efficient. Great stress is laid on the fact that good work builds up the socialist fatherland, throws down a challenge to foreign systems, and increases the present and future standard of living. This appeal has had an effect on the workers no less significant than similar appeals to patriotism in time of stress have had in foreign countries; an instance of its results is the number of people who could be found spending their free day per week doing voluntary labour when the underground was being built in Moscow; the enthusiasm of the younger workers, and especially those belonging to the Communist party, for building up the country has always impressed foreign visitors. Outstanding workers are rewarded with mention in the papers and public adulation, and may receive the "Order of Lenin" or some other decoration, while slackers find themselves pilloried in the wall newspaper which is a feature of most enterprises. Factories are encouraged to compete with each other for the honour of producing the greatest output, and successful establishments give their "patronage" to the unsuccessful, sending some of their best workers to assist their "wards" in building up output.

These non-monetary incentives play an important part in encouraging hard work and efficiency, but an equally important part is played by inequality of wages. Practically all occupations are paid for on a piece-work basis, so that fast workers earn



more than slow ones; the pace is set by "shock brigades" consisting of the fastest workers, and the wage system is so devised as to encourage the speeding-up of workers in ways which when tried in other countries have always been fought by the workers. The results are not always fortunate; following upon the publicity given to one Stakhanov, a miner who, by applying the principles of the division of labour (he arranged for his assistants each to specialize on one part of the job) achieved high output and high earnings, the speed-up campaign was so overdone in 1935 that the quality of work deteriorated in many cases as workers strained themselves to earn glory in the press and high wages. "Stakhanovism" is consequently not so popular to-day, but emphasis continues to be laid on piece rates to stimulate efficiency. Also, in order to encourage workers to improve their qualifications, skilled workers are paid much more highly than unskilled workers, and to secure that the correct proportions of labour shall be forthcoming in each occupation and industry, wages are raised in those where labour tends to be scarce.

Until the early years of the five-year plan, managers earned hardly more than the workers in their factories, and sometimes even less, but this is now ended. Managers have better salaries, better housing accommodation, greater privileges on the railways, and many other facilities not open to the ordinary worker. But the government has not yet solved the problem of developing initiative in its managers. To some extent it relies on their enthusiasm for building up the socialist fatherland; to some extent on public praise and abuse in the



press and factory newspapers; to some extent on control by the banking system, which is responsible for financing the operations of each establishment; to some extent on the "plan," which lays down what the concern is expected to produce within a given period; and to some extent on periodical audit by the "Commission of Soviet Control." But all this has not proved sufficient, and there are more complaints about the inefficiency of the "bureaucracy" in the Press than about practically anything else. In other countries, as we have seen in Chapter I, this problem is solved by making the earnings of managers depend on their ability to please the public, as reflected by the profits earned by their concerns; managers who succeed in reducing costs, or in introducing new or more attractive products to the public have high earnings, while those who lag behind in efficiency or lack initiative in improving quality and service make losses. The absence of competition between enterprises has thus been a drag on efficiency in Russia. The Communist party has now realized this and under new decrees managers are allowed in addition to their salaries to take a percentage of the profits earned by their enterprises. How far this process will go we must wait and see.

#### DISTRIBUTION OF INCOME

The result of the nationalization of the factories and the expropriation of the landlords by the peasantry is that there no longer exists any class of noblemen and investors living on rents and interest. Their income, however, does not all go to increase that of the workers and peasants. To some extent

the investors and land-owning classes performed important administrative functions in industry and in central and local government, and the persons who have taken their places now have to be paid salaries; part of the rents and profits used also to be set aside as savings, a function now performed by the government. It is therefore only to the extent to which the consumption of these classes exceeded that of the persons who now perform these functions that the Russian peasant and worker have gained.

How does the share of the national income going to the working-classes compare to-day with what it was before the Revolution? It is difficult to say as there are no reliable statistics on this point. In place of the old nobility and capitalists are the new factory-managers and government administrators whose standard of living is much higher than that of the ordinary worker. Nevertheless, there seems reason to believe that the share taken by the "upper classes" to-day is not comparatively as great as it was under the old régime. Moreover, social fluidity is much greater. It is far easier for the son of a worker to rise in the social scale, educationally and in terms of real income, than it has ever been before. How long this will last is of course uncertain; a high degree of social fluidity has been a feature of all expanding societies; when Britain and America were going through their constructional stages, men rose easily to positions of great responsibility, while to-day there is a tendency for those who have arrived to impose all sorts of monopolistic restrictions which reduce social fluidity. Russia is still passing through her constructional stage; whether or not she will harden into socially stratified classes,

with the technicians and administrators in the higher-income groups striving to keep their places for their children and to keep out the children of the poorer classes remains to be seen, but at present there is no sign of this.

Against this must be set the absence of freedom. In the political field this expresses itself through the dictatorship of the party, and the harrying of the G.P.U. On the industrial front it expresses itself in the absence of an independent trade union movement. Almost all the workers belong to trade unions—they have to join the unions in order to qualify for social insurance and some of the other social services—but as the unions are dominated by the Communist party on behalf of the government, it is probably true to say, as is often suggested, that they have hardly more independence than the “company unions” of America or the “Labour Front” in Germany, and this is one reason why the International Federation of Trade Unions has steadily refused their affiliation.

This has not always been so; in the years immediately following the Revolution the trade union movement was very powerful and independent of the government. Somewhat submerged during the civil war, it had its independence reaffirmed by a decision of the Communist party in 1921; but in the very next year came a decree which restricted its powers in government establishments. Succeeding years saw considerable discussion of the position which the movement was to hold in the new state, those of the old school insisting that it should be no less independent than in foreign countries, while others argued that militant trade union successes

gained by one group of workers could only be at the expense of others, or by the whole movement at the expense of the sums which the government had decided to set aside for industrialization, social services and so on. The latter view prevailed at the party congress in 1928. Tomskey, the President of the movement, who had championed the demand for independence, was dismissed from his post and expelled from the party, and the movement became subservient to the party and the government. Nevertheless, a show of collective bargaining is still made. Members of the central committee of the movement meet annually with industrial managers and "Gosplan" to decide what the level of wages shall be. Just how important this collective bargaining is it is difficult to say. It is sometimes argued that as all three parties are in practice merely the agents of the government and as members of the Communist party bound to accept its decisions, the resultant "bargain" is of little significance, but it must not be lightly assumed that the government is out to exploit the workers or that they are unable to exercise any pressure. In Russia the state is almost the sole employer, able to pay more or less what wages it likes, and to use its profits to increase the salaries of government officials, to build magnificent offices, to spend money on propaganda to keep itself in office, to carry out industrialization at a pace greater than the public desires, and so on. But it would be wrong to suppose that the government is determined to keep wages as low as possible. On the contrary, in the long run it can only maintain itself in power by increasing the workers' standard of living, and has therefore an incentive to pay as

high wages as possible. The most that can be said is that the worker's fate is in the hands of a government over which he has little direct influence.

Besides the position of the worker we must also consider that of the peasant. Urban workers are in a minority; two-thirds of the population consists of peasants, and to them the revolution has brought an exploitation as terrible as anything that ever happened under the Czars. The revolution was neither made nor won by the urban workers; it was the continuation of an unsuccessful peasant revolution of 1905, and of scores of intervening local revolts. When the revolution started a pact was made between the "Social Revolutionaries" (the peasant party) and the Communist party, and throughout the civil war which lasted till the end of 1920 it was mainly the man-power and determination of the peasantry, helped by the workers in the factories, that succeeded in defeating the forces of the *ancien régime*. In the course of the civil war administrative power passed into the hands of the Communist party, which was centred in the towns and in control of the factories, and it was after the war that the peasants' troubles began. For in due course the Social Revolutionaries were shot or expelled, and the peasants made to pass through periods in which the new government took more from them than had ever been taken before.

The roots of the trouble have been twofold. First, the determination of the Communist party to industrialize rapidly, which necessarily bore heavily on the peasants. It was necessary to get as much grain as possible from them while supplying them with as few manufactured products as possible in

exchange. This was done partly by requiring the peasants to hand over certain quantities of grain to the government as a sort of tax, and partly by lowering the prices of agricultural products relatively to those of manufactured goods, so that the peasant was unable to buy as much as before with the money he got for his grain. The other cause of the trouble was the Communist mania for size and machinery. Impressed with tales of the size of American farms and the marvels of American agricultural machinery, many Communists wished to root the peasant out altogether, and replace him by huge plantations on which he would be just a labourer. Some start was made on these lines with the establishment of a few state farms, but the policy never got very far partly because the farms proved too large to be efficient, and partly because it would have involved too serious a war with the peasants.

Peasant discontent grew steadily throughout the period of the New Economic Policy as a result of the excessive requisitioning and the disparity between the prices of agricultural and industrial products. Simultaneously the peasant contracted his sowings, on the ground that if his earnings were to be reduced there was no point in his working so hard. By 1927 the government was faced with the difficulty of getting as much grain as it wanted out of the peasants, and it was partly this and partly the dislike of the peasant system of agriculture which caused the party to decide in 1928 on the "collectivization" of the peasantry.

Thus began a battle which lasted four years, and in the course of which millions of peasants starved,

died or were banished from their villages. The Communists have tried to justify this as the "liquidation of the *kulak*," a nickname given to the richer peasants. But there were hardly any *kulaks* left in Russia in 1928. Immediately after the revolution the poorer and middle peasants had seized the land of the nobility and the richer peasants, and shared it out on a more or less equal basis. It is significant that in the battle that followed practically all the peasants stood together, and occasionally the government had to banish almost a whole village in order to accomplish its ends.

Collectivization began in 1929. The peasants were invited to join collective farms, i.e., to throw all their land and livestock into a common pool to be worked as a co-operative society. Distrusting collectivism as such, and realizing that a principal result would be to make it easier for the government to collect as much grain as it wanted, the vast bulk of the peasants refused. Collectivization then became virtually, but not legally, compulsory; those who refused found themselves banished from their homes, and their land expropriated. The peasants retaliated by slaughtering their livestock rather than give them to the collective farms (in one year the number of animals was reduced by sixty million, a quarter of the total) and by murdering as many of the government's officials as they could lay their hands on. Nevertheless, within a year 50 per cent of the peasants had been collectivized, but the discontent and the slaughter of stock were so serious that early in 1930 Stalin called a halt, decreeing that thenceforward collectivization should be voluntary; whereupon more than half the peasants



immediately withdrew from the collective farms. Good weather brought a bumper harvest in 1930 which renewed the government's courage. Pressure was renewed in 1931 and 1932, while the peasants on their side retaliated by further destruction of livestock (between 1929 and 1934 the number of livestock was halved) and by reducing sowings to a minimum. Unfortunately, the weather was unfavourable in many districts, and this combined with reduced sowings and the slaughter of cattle to produce famine conditions over large parts of Russia in 1932. The famine could have been mitigated by the cessation of exports, but the government acted as though it were taking the opportunity to teach the peasants a lesson once and for all. Despite the famine it requisitioned almost as much grain as before, with the consequence that the peasantry were not left with enough to eat, and hundreds of thousands died from starvation, typhus and other famine diseases. Thus the spirit of the peasantry was broken. Early in 1933 the government reorganized its agricultural department and dispatched 25,000 picked communists to carry through collectivization, which was accomplished within a few months.

However, the battle has not gone entirely to the government, for partly to win the confidence of the peasantry various concessions have been made. Each peasant on a collective farm is allowed to keep in private ownership up to three cows, twenty-five sheep and goats, unlimited poultry, and up to two and a half acres of land; the amounts requisitioned by the government have been reduced; peasants are once more allowed to visit the town



markets in order to sell their produce freely, instead of having to sell it all to government establishments; and the ratio between agricultural prices and industrial prices has been reduced in favour of the peasant. These measures, combined with the rapid extension of educational facilities and the slower but steady spread of other social services have considerably improved the lot of the peasant. Nevertheless, although the peasants constitute two-thirds of the population, they are still able to purchase only one-third of the output of industrial goods, so there is much leeway to be made up.

#### CONCLUSION

It has often been said that it is a great tragedy for the socialist cause that socialism should first have been tried in a country with a traditional disregard for human freedom and the dignity of human personality. It is also a tragedy that the task should have been in the hands of men who, on their own admission, had little idea when they attained to power of the nature of the economic problems they would have to face. There can be little doubt that the socialization of property could be an improvement on the distribution of property under the Czarist régime, and on the concentration of property in the hands of a few private persons which characterizes other countries to-day. The rapid spread of education and other social services, and the destruction of the barriers which reduced the chances of the children of the poor compared with those of the rich, are achievements of which Russia can be proud. It is unfortunate that the beneficial effects

of these changes are so largely submerged by the ignorance and fanaticism of the government.

So far, Russia teaches little beyond the fact that a dictatorship can do within limits exactly as it pleases. Future democratic socialist governments will get little guidance from what has happened so far save as a warning of what to avoid. The next twenty years, however, may bring great changes. The government has already learnt much, and the people are now much better educated than they were when the experiment began. If it, or some new government in Moscow, should decide to pay more attention to the free choices of its people, centralized planning and other forms of dictatorship may be discarded altogether or at least modified, and the country may settle down to work out the technique of administering a free socialist economy.

#### SUGGESTIONS FOR FURTHER READING

There is a mass of material on Russia, but most of it is biased one way or the other, and unreliable. Among the best books are Dobb: *Russian Economic Development* (1928), Hoover: *Economic Life of Soviet Russia* (1931), Chamberlin: *Russia's Iron Age* (1935), and Hubbard: *Soviet Money and Finance* (1936). Webb: *Soviet Communism* (1935), covers the whole ground, but is badly biased.

## CHAPTER VI

# GERMANY

### HISTORICAL BACKGROUND

AT the outbreak of the Great War in 1914 Germany was one of the wealthiest nations in the world; ten years later she was on the verge of collapse. While the War lasted it diverted her resources to the production of armaments and her men into the battlefields; machinery and other equipment deteriorated and could not be replaced until peace returned; and imports were reduced by the enemy blockade. Defeat brought further troubles; some of the richest districts were taken over by France and Poland, and reparations both in money and in kind were demanded by the victorious powers. Severe readjustments would be necessary before the country could settle down again; the armament industries would have to contract, labour and other resources being directed to industries producing the needs of peace, and the structure of prices, wages and incomes would have to alter in response to changes in the relative importance of different products.

Unfortunately, instead of getting down to this immense task of reconstruction the country went through another great misfortune, a monetary inflation. For in order to meet its expenses the

government printed new banknotes. As the quantity of money increased more rapidly than the quantity of goods, money became less valuable in terms of goods, that is to say, prices rose. Thus a spiral movement began; the rise of prices induced the government to issue more money, whereupon prices rose further; still more notes were printed, and prices rose further still. This process continued until prices had reached fantastic heights. In 1914 the mark was worth about a shilling; by 1923 prices had risen so high that the cost of a newspaper was 200,000,000,000 marks, and the cost of a tram ticket 150,000,000,000 marks. In other words, the mark had become practically valueless.

Now if all prices and wages had risen in the same proportion all this would not have mattered very much; but this, of course, could not happen. Some prices are fairly stable, like wages, rents, interest on loans. The people who were least hit by the inflation were bankers and industrialists who bought goods or labour at one price and could sell their products a few days later at much higher prices owing to the increase in the quantity of money. On the other hand, wage-earners, people who had left their savings in the banks and those who had lent money or rented out houses or land found that by the time they received their money it had lost much of its value. Eventually, in face of popular discontent, especially among the workers and middle classes whose savings disappeared, the government was forced to cry halt. Towards the end of 1923 the printing of the old marks was stopped. Instead the government issued a new mark and stabilized it at a value equal to one million million of the old

marks. This new mark, at first called the "rentenmark" and now called the "reichsmark" or simply the mark, was carefully controlled in supply, and succeeded in regaining the confidence of the public.

By this time five years had elapsed since the end of the War without the country being able to settle down to the necessary readjustments; indeed the situation was worsened by the inflation since all sorts of new bubble concerns were set up which depended on a continuous rise of prices, and would collapse as soon as stability was achieved. This happened at the end of 1923 and early in 1924; there were numerous bankruptcies and an increase in unemployment, but after a few months reconstruction began. Equipment had to be renewed and production adapted to the new conditions of supply and demand in the post-war world. There was a shortage of capital, but foreign countries came to the rescue, and with the help of substantial foreign loans German industry was reorganized and re-equipped between 1924 and 1929.

This reorganization, however, contained within itself the seeds of further trouble. The industries producing machinery and other capital equipment engaged large numbers; when reorganization was complete these industries began to decline and unemployment emerged. This by itself was not a grave danger as labour could have been diverted to other industries if funds had been available. But it happened that simultaneously foreigners began to withdraw their funds from Germany for a variety of reasons. The boom in America attracted funds from Germany, and the subsequent collapse in August 1929 also had the same result, as some

investors got scared and wanted to have their funds at hand. The French also withdrew funds on two occasions for political reasons, once in 1929 to frighten the Germans into accepting the Young reparations proposals, and again in 1931 to discourage them from a proposed customs union with Austria. These withdrawals of capital led to a severe contraction of credit in Germany, and many firms were forced to close down. And on top of all this came the world slump which reduced the market for German exports, and the tariff policies of Britain and America reducing it still further, so that more firms had to contract. From 1929 to 1932 unemployment rose steadily until it reached the enormous figure of six million. The disorganization of economic, social and political life which resulted can easily be imagined.

#### THE RISE OF "NATIONAL SOCIALISM"

It is in this background that we must see the rise of "National Socialism" in Germany. 1914 to 1933 was a period of nineteen years of which only five (1924 to 1929) had any semblance of normality. The economic disorganization of these years was paralleled by the spiritual exhaustion and mental confusion of the people. The Kaiser's government had been overthrown by revolution in 1918, and a very democratic constitution adopted. The new rulers of the country were more or less able men, of liberal temper, but they lacked the imagination and the glamour necessary to restore confidence to a defeated people, and the very fact that as rulers of the country they had to be associated with repara-

tions and with the difficult economic readjustments, doomed them from the start. At times like this it is easier to oppose than to govern, and many new political groups emerged playing on popular emotion in the hope of gaining power.

To one of these, the "German Workers' Party," Herr Adolf Hitler, an Austrian odd-job painter who had been a lance-corporal throughout the War, attached himself in 1919. It was fairly small, and he soon gained control of it, converting its name to the "National Socialist Party." Its main line was a fierce nationalism. Most Germans felt very keenly the loss of the War and the conditions imposed by the peace treaties; the racial doctrines of National Socialism and its denunciation of Jews and foreign powers helped to reflate their national pride; so did its emphasis on leadership, its processions, the emotionalism of its speakers and propaganda, its uniforms and its talk of comradeship. The middle and small propertied classes, ruined by the inflation and too proud to associate with the working-class parties, began to flock to it in large numbers. Later its opposition to communism brought it the support of some of the large landowners and some of the monied industrialists. It was, however, the deepening economic distress after 1929 which gained the party most of its recruits. A party which could blame all the troubles of the day on to Jews and foreigners, and could promise national regeneration under "Nordic" leadership, found millions clutching at it as at the proverbial straw. Its numbers grew rapidly, and eventually, in January 1933, after various changes of government, President Hindenburg invited Hitler to form a minority government.



This is not the place to enter into the political aspects of the Nazi régime—the creation of the dictatorship, the suppression of liberty by the Gestapo and the Ministry of Propaganda, and so on. What we are concerned with is the economic policy of the régime. This has been dominated by two aims, the first to reduce unemployment, and the second to increase the military strength of Germany. The methods used to secure these aims are of great interest to our comparison of the ways in which different countries solve their problems.

#### UNEMPLOYMENT

Take unemployment first. By 1933 the economic situation had passed its worst point. Unemployment totalled six million, but conditions had been improving since July 1932. World recovery from the great depression began in 1932, and swept most countries upwards with it. The Nazis were therefore fortunate in assuming power when recovery was already on its way. Nevertheless the measures they adopted helped to accelerate the increase of the numbers at work.

The keynote of their policy was large government expenditure. Money was created and poured into the economic system through three main channels—labour camps, public works and armament production. We shall say a word on each of these.

When the Nazis assumed office they found that some of the young unemployed were being maintained in labour camps, and they extended the system until at one time there were nearly a million in the camps. No wages were paid; the men were set to



dig holes in the ground in connection with various schemes which were not always very useful but at best included land reclamation and road-making. The three principal objects of the camps were to reduce the number recorded as unemployed, to improve the physical condition of the young men, and to provide them with something to do. As recovery proceeded the country could not afford to have so many men engaged on work of little immediate value, and the numbers were reduced. Nevertheless, the idea of such physical exertions appealed to the Nazis and so they made the system compulsory; every young man must now spend six months in a labour camp immediately before doing his military service, the number involved at any time being about 200,000.

The Nazis also found that money was being spent on public works to provide employment, and they allocated large funds for this purpose. One plan was to build five thousand miles of new motor roads for very fast traffic, partly to relieve congestion on existing roads, but even more to facilitate the movement of troops to the frontiers. Other public works included housing. The re-housing of the population had been making great strides prior to 1929, but was handicapped by the depression. The Nazis took over this policy as well, but gave it special twists in two directions. First, disliking flats they encouraged the building of small suburban houses with gardens; and secondly, disliking the large city they have tried to decentralize the population by building new industrial towns in rural areas. Town planning is also much in favour, so that at the cost of increased expenditure on transport, the new Ger-

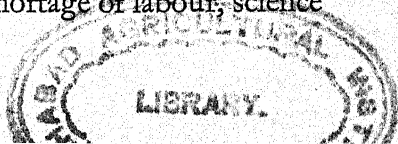
many is somewhat more pleasant to look at than the old.

The greatest public works expenditure, however, has been on armaments. Not only has the new army itself absorbed something like a million men, but employment has been created in factories producing aeroplanes, guns and so on.

It is not possible to say just how far the vast sums spent by the government are responsible for the increase in employment. As we saw in Chapter IV, a similar increase in employment occurred in Great Britain where the government did not adopt the public works policy. It seems, however, very probable that the sums spent by the Nazi government did make an important contribution. Unemployment has been reduced from six million to negligible quantities; there is now a great shortage of labour, and immigration from neighbouring countries is being encouraged, especially to help in agriculture. The standard of living is also higher than it was in 1932, a fact which the government exploits to the full in its propaganda, while neglecting to mention that Germany is one of the few countries of Europe where it is no higher than it was in 1929. This itself is a warning of the limitation of the public works method of curing unemployment; for unless the work which people are set to do is productive, the increase in employment is so much labour wasted.

The success of its major weapon for demolishing unemployment has enabled the government to dispense with certain minor ones which were, in any case, of doubtful value. The first was the policy of dismissing women and putting men into their jobs.

This policy does, of course, reduce the number of people recorded as unemployed if the government decides to exclude women from its records, but it does nothing really to increase the volume of employment. It was accompanied by the offer of marriage-loans to women who left their jobs to get married, a loan of about £50, repayable monthly in eight years, 25 per cent of the loan being cancelled for each child born (this provision is designed to encourage the growth of the population). The policy of getting women out of industry was accompanied by much propaganda to the effect that woman's place is the home, but it proved to be only temporary. For the subsequent recovery produced a shortage of labour. Women were once more needed in industry, if only to help to produce armaments. The policy was therefore reversed; everything is now done to encourage women to leave home and enter industry; and the marriage loan can now be had even by women who keep their jobs after marriage. A second weapon was to reduce the number of hours worked per week in order to share employment. This also has been reversed. The shortage of labour for armaments has been met by increasing the length of the working day, till in many industries Germans are having to work longer than workers in any other country in Europe. A third weapon was to prohibit technical improvement. In 1933 firms were compelled to use as much labour as possible; the introduction of new machinery was restricted; and the public works schemes planned to do as much work by hand as possible, so as to increase the number of hands engaged. To-day, with a shortage of labour, science



and technical invention are no longer reviled as "un-Aryan"; and every hope is placed on rationalization to increase the productivity of labour. These three weapons attracted much attention in foreign countries when the Nazis applied them, and there were many people who urged their adoption elsewhere. Whatever their merits as short-term policies, it is clear that they offer no permanent solution.

#### ECONOMIC ORGANIZATION

Now we come to the second aim of Nazi policy—the militarization of Germany—and the economic changes which it has involved. The method of the Nazis has been to take control over the whole economic system, so as to be able to use resources in whatever way suits them best. There has thus been (i) control of industry, (ii) control of foreign trade, and (iii) control of labour.

*Control of Industry.* To some extent the government obtains the resources it wishes by heavy taxation (including the cruel and deliberate robbery of the Jews), and by creating new money with which to purchase the resources it needs, thus reducing the amount of resources available for non-military purposes. To some extent too it relies on propaganda; articles in the press and talks on the wireless seek to persuade the German consumer to purchase only those things which are not much needed for armaments, and to do without those of which there is a shortage. But as its principal weapon the government relies on a close control of industry. In pre-Nazi Germany production was governed by

prices; firms whose product the public valued could pay higher prices for their materials and labour than those whose products were not so urgently required; but in Nazi Germany prices have been kept more or less stable since 1936, under a law which fixed them at the level then ruling; production is now controlled by permit, so that only what the government allows can be produced. For example, certain raw materials are rationed; a firm is only allowed to buy them if it gets special permits stipulating how much it may buy, and these permits are distributed in such a way as to ensure that armament purposes come first. Similarly new equipment cannot be laid down without a permit; and for some time all profits above 6 per cent had to be invested in government loans.

Elaborate and very complicated machinery has been built up for regulating industry, and there are so many separate bodies supervising this and that aspect of a firm's activities, that in some cases it may be necessary to fill up forty forms before permission is granted to undertake a small transaction. There is one office controlling prices; another rationing imported materials; another controlling foreign exchange, and so on; and as the government's left hand does not always know what the right hand is doing there is frequent confusion which reduces the efficiency of industry. In addition, government control is facilitated by compelling firms to belong to various organizations with legislative power, such as cartels, which regulate output and prevent competition, chambers of commerce, through which a number of government instructions are transmitted from Berlin, and the Labour Front (of which more later) controlling labour policy. Industry has

not been nationalized in Germany, but it is so closely regulated as to be no more than the servant of the government.

*Control of foreign trade.* Since 1935 the demand for materials connected with the manufacture of armaments has considerably increased, and in order to obtain them from abroad Germany has naturally to offer more exports in exchange. The government has, however, kept German prices so much above the world price level that foreign countries have not been willing to give up their raw materials in exchange for German exports at the prices quoted. Imports of all but essential materials have therefore had to be reduced to a minimum, and permits to import are strictly rationed. Various devices have also been adopted in an attempt to get over the difficulty of the high price of German exports. One device is to subsidize exports, i.e., in effect to sell the goods more cheaply to foreigners than to home consumers. Another is to have special marks of low value, which enable special classes of foreigners to get certain goods cheaply; this is also a sort of subsidy. A third device has been to encourage foreigners to send their goods to Germany, and when the time comes to pay for them to say that Germany is unable to pay because foreigners will not buy from her—some fairly large debts have been run up in this way, especially at the expense of traders in Central and South European and in South American countries, and in consequence these countries have often had to buy from Germany goods which they did not want at prices which were much higher than elsewhere. Some small countries to whom the German market is important have also

complained that she has used her bargaining strength to compel them to buy from her at prices higher than could be obtained elsewhere.

At the same time the government has striven to make the country as self-sufficient as possible so that in the event of war she may be independent of foreign supplies of foodstuffs and raw materials. The "Four-Year Plan," announced in 1936, is a scheme for subsidizing the production of substitute materials, and financing scientific research into the development of new materials. So far it has not proved very successful, though of course scientific research depends so largely on luck that anything may happen at any moment. A process was invented in 1921 for making a new textile fibre, "Vistra," or "staple fibre," from wood, and mixing it with wool, cotton or linen. The Nazis have spent much money on it, but as yet it is still unable to stand up to the weather. They have also spent money on producing "Buna," a substitute for rubber, which has been on the market since 1932. There are also substitutes for oil and petrol. The new substitutes are all very much more expensive to produce than the materials they replace, but the government thinks the expenditure worth while in order to make the country independent in case of war.

Much attention has also been devoted to making Germany self-sufficient in foodstuffs. Agriculture has been organized into a series of boards, one for each product, which fix prices and subsidize production of foods which have hitherto been imported. Agricultural wages have been stabilized, and much of the work of the labour camps has been directed to the improvement of agricultural facilities. Need-



less to say, the farmers—and not least the great Prussian landlords—have derived great benefit from all these measures, at the expense of the urban consumer whose cost of living has risen.

*Control of labour.* The supply and remuneration of labour have been affected in two ways: (a) by conscription, and (b) by the destruction of the trade union movement.

Labour has been conscripted for three purposes. First, the labour camps. As we have seen, these began as physical training camps for the unemployed. Now that unemployment has practically disappeared, they have two uses; they give young men six months of hard physical labour in open-air surroundings, and equally important, supply the government at a low cost with labour which it uses to drain swamps, build roads, and perform other public work. Secondly, the army. Every fit male has to do military service on reaching the prescribed age, and to serve when Germany is at war. And, thirdly, the fortifications. In 1938 the government hurriedly decided to complete the fortification of the western frontier by building the "Siegfried line." For this it required skilled labour, and as it was in a hurry, it simply conscripted the workers it wanted and ordered them to proceed to the job. In these ways the right of workers to dispose of their services as they think fit has been limited.

The destruction of the old trade union movement was one of the first acts of the Nazi government. In its place was established the "German Labour Front," to which both employers and employees must belong. A law of 1934 set out the attitude of the new régime to labour. The employer of each



establishment was recognized as the "leader" and the workers as the "followers." To the leader belongs full responsibility, but to advise him there is a "mutual trust" council of representatives elected by the workers from a list drawn up by the Nazi cell which exists in each firm. Disagreements on wages or other questions must be referred to the "Labour Trustees" appointed by the government in each district, and for offences against the dignity of labour an employer can be brought before a "Social Honour" court. All this is very different from the previous régime, when an independent trade union movement negotiated freely on wage and other issues, and the dignity and security of the worker were protected by the courts under very comprehensive legislation. Wages are now fixed by the government, and have been kept at a stable level since 1934; and in addition much of the public works is executed at wages far below anything which the trade unions would have permitted. On the other hand, with the authority of the government behind it, the Labour Front is not by any means docile in face of the employer, some of its "suggestions" for improvements being strongly resented by many employers who find it in some connections much more powerful than the old trade unions. In addition the Labour Front has a "Strength through Joy" department which provides cheap leisure facilities for the workers, including cheap travel and theatre tickets, the money for this coming partly from workers' contributions, partly from levies on employers, and partly from state subsidies. This is the sugar which coats the pill of the absolute subjection of the worker to the government.

## CONCLUSION

The system we have been examining in this chapter is really most adequately regarded as a war economy. The allocation of resources in Germany since 1933 and the machinery of control bear much more resemblance to the economic system of a country at war than to that of a country at peace. Perhaps the best commentary on its working is what has happened to the German standard of living. Most other countries in Europe now have a much higher standard of living than in 1929; the German standard, on the other hand, has risen from the depths to which it had fallen in 1932, but is still no greater than it was in 1929. To a very large extent this is due to the diversion of men and resources for military purposes, but there can be little doubt that the cumbrous and inflexible machinery of control has played its part. In the economic sphere, as in the political sphere, it is freedom from arbitrary state control which makes progress possible.

## SUGGESTIONS FOR FURTHER READING

Two good general descriptions of the Hitler régime are Roberts: *The House that Hitler Built*, and Trivanovitch: *The Economic Development of Germany under National Socialism*. On unemployment policy see Guillebaud: *The Economic Recovery of Germany*; and on foreign economic relations, Muhler: *Hitler's Magician, Schacht*.

## CHAPTER VII

### FRANCE

**F**RENCH economic history since the War teaches three lessons. First, the period from 1919 to 1928 illustrates the effects of inflation. Secondly, the period from 1931 to 1936 illustrates the difficulties which emerge when there is serious maladjustment in the foreign exchanges. And, thirdly, the Blum experiment throws light on the effects of all-round wage increases and a reduction of hours by law. Let us begin with 1919.

#### POST-WAR RECONSTRUCTION

The War of 1914-18 wrought havoc with the economic life of France. It killed one and a half million of her young men of working age, and severely wounded or crippled another million and a half. Her richest industrial districts were the scene of continuous destruction, and as wide areas with their houses, factories and mines were devastated, production fell to less than half of the pre-war level.

Immediately after the War France set about the gigantic task of reconstructing her devastated areas. To make up for the shortage of labour, foreign workmen were encouraged to immigrate, and their numbers grew to over three million. The cost of reconstruction ran into hundreds of millions of

pounds. It was hoped at first that this cost could be extracted from Germany in the form of reparations, and efforts to extract it form the background of international politics in the thirteen years after the Armistice. In the meantime the money was created by inflation. The government got the Bank of France to print new notes, which it promptly borrowed and used to pay for reconstruction. So rapidly and efficiently was the job done that within a few years the war districts had been almost completely restored.

But the method of financing had other results too. The people to whom the new money was paid used it to buy foodstuffs, clothing, and materials of all sorts, but as the number of these was limited their prices rose steadily as the issue of money was increased. The rise in French prices was reflected by a fall in the value of the franc in terms of other currencies. Whereas in 1913 the British pound could buy only 25 francs, by 1924 it could buy more than a hundred. Moreover, it was clear that if government expenditure continued at the same rate, and if it was still met by issuing new money, prices would rise still further and the value of the franc fall even lower. People began to speculate on the fall of the franc, selling francs for pounds and dollars with the intention of buying them back when their value had fallen even lower. At the same time the fall of the franc produced a political crisis in France, lasting from 1924 to 1926, in the course of which politicians brought forward various plans for increasing taxation and reducing expenditure so that, having a balanced budget, the government would not have to print any more notes. The

political crisis itself reacted unfavourably on the value of the franc, which fell to as low as 240 to the pound in July 1926. Eventually a stable and resolute government was formed by M. Poincaré in the latter half of 1926. By drastic increases of taxation it balanced the budget, and as the crisis subsided the franc rose steadily in value. Within a few weeks the government was able to authorize the Bank of France to stabilize its value at 124 to the pound, by offering to buy and sell francs freely at that rate, and two years later, in 1928, returned legally to the Gold Standard at that parity.

At the new parity the pound could buy nearly five times as many francs as before the war. But as French prices were not really as much as five times as high as British prices, French goods were very cheap to those who had British or any other foreign money. The consequence was a great development of French exports, and a very high level of employment. Of course the other side of the picture was that the foreign goods imported into France were now more expensive, but this aspect was overlooked by most people in the general atmosphere of prosperity produced by large exports. The industrialization of the country also proceeded rapidly. In 1911, out of a total population of  $39\frac{1}{2}$  million, the urban population constituted  $17\frac{1}{2}$  and the rural 22 million. By 1930 the total population of 40 million was divided almost equally between town and country.

#### THE GREAT DEPRESSION

Thanks to the cheapness of her currency, France succeeded much better than other countries in

weathering the first two years of the slump, since her exports, being relatively cheap, did not fall off as much as the exports of other countries. But in 1931 Great Britain and a number of other countries left the Gold Standard, thus lowering the value of their currencies in terms of the franc, so that by the end of 1932 the pound could buy only about 75 francs. French goods thus became very expensive; exports fell off and unemployment increased. If France had left the Gold Standard at the same time as Great Britain she could have avoided the subsequent difficulties, but for political reasons she preferred not to do so. The French public, and especially those sections of it who gained by the cheapness of foreign money, had considered the fall of the franc in the early twenties to be a national disgrace, and were determined not to let it happen again.

But the only alternative to devaluation of the franc was to lower French prices, so as to enable French goods still to compete in foreign markets despite the dearness of the franc. For the next few years, till 1936, this policy was steadily pursued. The issue of money was severely restricted, wages forced down, and prices lowered. Now if all prices and wages had fallen to exactly the same extent serious hardship would have been avoided; but, of course, things do not happen in this way. Some wages and some prices fell more than others, so that some people became better off while others were poorer. The government too was seriously embarrassed. For as incomes were reduced in terms of money, the yield of taxation fell; but though it cut the salaries of civil servants, and reduced other expenditures, it was unable to reduce its total expen-

diture to the same extent as its receipts had fallen. Hence the national debt steadily increased, and as money was not always easy to borrow, the treasury found itself in continual straits. This in turn produced a political crisis, and led to a succession of governments from 1932 to 1936, each producing new proposals for balancing the budget, but none succeeding.

Eventually at the new elections of June 1936, a new government was returned. Three political parties on the left, the Radicals, the Socialists and the Communists, had agreed on a joint programme, and stood for election as a "Front Populaire." No one party got a majority in the Chamber, but together the three parties were able to command a majority. The Socialist Party was the largest of the three, and so its Leader, M. Leon Blum, became Prime Minister.

#### THE BLUM EXPERIMENT

The "Front Populaire" was a coalition depending for its support principally on the working classes and the small shopkeepers and peasants. Its economic programme was therefore radical. We shall not go into all its aspects, such as the nationalization of armament firms, carried out to curb the power of the "merchants of death," or the reform of the Bank of France, bringing it under direct government control; we shall concentrate attention on the measures undertaken with the object of improving the standard of living of the masses.

So soon as the return of the "Front Populaire" was assured, and before even the new government



could assume office (two weeks had to elapse between the elections and the formation of a new government), a "stay-in strike" movement spread rapidly; workers all over France stopped work, and to prevent employers from engaging substitutes remained in the factories day and night. The strikes took the political and trade union leaders by surprise. They were a spontaneous movement by the masses, partly showing their joy and consciousness of power at the return of their representatives to the Chamber, after four years of low wages and unemployment, and partly designed to impress the new government with the need for speedy action. They did indeed succeed in frightening the employing classes into granting various demands, and frightening the Senate (a sort of "House of Lords") into passing the legislation of the new government. But being unorganized the strikes were difficult to restrain, and their length was somewhat embarrassing to the government.

Anyway, the immediate result of the strikes was that the employers' federation met the trade union representatives, at the instance of the government, and signed the "Matignon" agreement, the most important clauses of which granted substantial wage increases, and acknowledged the right of workers to bargain collectively with their employers. This agreement was regarded as somewhat of a charter for French trade unionism. Immediately after the War trade unionism had been fairly strong, but for various reasons it had declined, and at the beginning of 1936 included only one and a half million workers. The victory of the "Front Populaire" and the success of the stay-in strikes



gave a fillip to the movement; within a fortnight numbers had reached three million, and within a few months the figure had become five million.

In execution of the Matignon agreement the trade unions proceeded to negotiate, and succeeded in getting substantial increases in wages. At the same time the government passed laws entitling every worker to a fortnight's holiday with pay every year, and reducing hours of work from the previous level of about 48 to 40, without any reduction in weekly wages. The result of all this was a rise in wages equivalent to about 60 per cent. Great things were expected of this rise in wages, but we have already seen in Chapter II that wage increases secured in this way most often benefit some workers at the expense of others, and seldom benefit the whole working class at the expense of other classes. The result of the general increase of wages in France was that prices rose immediately, and unemployment increased. The cost of living rose by about 27 per cent during the year of the Blum experiment. Hourly wages, on the other hand, rose 60 per cent, and weekly wages by about 33 per cent (as the worker was doing only 40 hours instead of 48, weekly wages rose less than hourly wages). The worker's standard of living thus improved to the extent of  $1.33 \div 1.27$ , i.e., by about 5 per cent. Roughly speaking, the manual worker had improved his position in that his standard of living remained more or less unaltered though he was working less hours per week.

But this was only the manual worker. At whose expense did he make this gain? Not at the expense of the big industrialists. On the contrary, the big

industrialists also seem to have improved their position. The real losers were small shopkeepers and also those other classes of workers whose wages did not rise to the same extent as those of manual workers, viz., shop assistants, clerical workers (often worse paid than manual workers), civil servants and pensioners; most of these secured some increase of hourly rates, but not an increase sufficient to cover the increased cost of living, and thus contributed to what was gained by the manual workers.

As for unemployment, the effect of the wage increases was most marked. The index of unemployment, corrected for seasonal variations, rose from 163 to 173 between May and October 1936. Industrial output fell (May to August) from 102 to 93, and exports from 79 to 74 (May to October). These results were not at all surprising to economists, but they seem to have taken the government by surprise. It appointed a special commission to control prices, but the commission realized that little could be done without increasing unemployment, and was more or less inactive. Indeed, even as it was, the government had to allocate special funds as loans to small employers to help them to pay the increased wages, in order to prevent unemployment from increasing still further. Thus was definitely disproved the theory that an increase of wages, by increasing the purchasing power of the masses, would increase the incentive to invest and diminish unemployment.

Largely contributing to the increased unemployment was the decline of exports, which was itself due to the increased prices which higher wages brought about. French prices were now more than

ever out of step with prices elsewhere. Accordingly, in September 1936 the government decided to devalue the franc, in agreement with Britain and the U.S.A. Devaluation once begun, it was continued on subsequent occasions until in May 1938 the franc was stabilized at around 180 to the pound. The effects of devaluation on employment can be read in the statistics; from October 1936 to April 1937 exports rose from 74 to 88, and industrial production from 93 to 99, while unemployment declined from 173 to 143.

To some extent the decline of unemployment was also due to the 40-hour week, which began to be applied at the end of 1936. In fact, by April 1937, employment had been so shared out that unemployment had reached its minimum. Further application of the 40-hour week during the year did not increase employment, but simply curtailed production. Between March and October 1937 production fell from 105 to 100, and exports (March to November) from 88 to 81, while the index of unemployment remained unchanged. The workers welcomed the 40-hour week because it enabled them to work five days a week instead of six, and therefore gave them *deux dimanches* to enjoy instead of one. But, on the other hand, to reduce hours from 48 to 40 was to reduce the potential output of French industry by about 17 per cent. This was happening, too, at a time when the international situation was growing steadily worse, and additional French output and armaments were thought to be necessary. By November 1938 the international situation was so bad that the government of the day decided to remove such a heavy restriction on potential output. The Blum

government had already fallen, and the government in power issued various decrees the net effect of which was to facilitate working for more than 40 hours, and to make it virtually illegal to work only five days a week. Thus the *deux dimanches* were lost.

We must also give some attention to agricultural policy. The "Front Populaire" owed its support not only to the working classes but also to the peasantry, and accordingly had to do something to help them. As a result of the fall in the world price of wheat, and the over-valuation of the franc from 1931-6 which made imports cheap, the price of wheat in France was very low, much to the disgust of the half of the population engaged in agriculture. Previous governments had adopted measures raising prices, such as imposing heavy import duties, financing the storage of wheat to keep it off the market, destroying wheat, restricting the acreage planted, and fixing a minimum price, but agriculturists were still dissatisfied. Consequently the "Front Populaire" government in August 1936 established an "Office du Blé" whose main function was to fix the price of wheat and see that this price was rigidly adhered to. It was recognized that the subsequent increase in price would raise the price of bread to the disadvantage of the urban population; and some attempt was made to overcome this difficulty by reducing the margin between the price of wheat and the price of bread at the expense of the millers, but in the main the increase in price fell on the urban population. However, as the urban workers had received wage increases, and as the prices of the industrial goods the agriculturists had to buy had

also gone up, the combined result of raising industrial and agricultural prices seems to have been, at least in the first year of the experiment, that neither the peasant nor the worker gained or lost much.

Finally the Blum government fell for the same reason as most of its predecessors—the state of the budget. In order to reduce unemployment the government increased its expenditure on public works. Simultaneously it increased the salaries of civil servants, organized a costly world exhibition, and found itself forced to spend large sums on increasing armaments, in view of the rapid rearmament of Germany. The national debt grew steadily, and almost exactly a year after assuming office, when M. Blum asked in June 1937 for wide powers to take whatever steps he might think necessary to improve the financial position, the Senate overthrew his government. The new government formed by his successor was still formally under the mantle of the “Front Populaire,” but in fact the experiment was at an end.

#### CONCLUSION

It is impossible to sum up the Blum régime merely in terms of its economic policy. Its effect on the general spirit of the masses, its international policy, and other aspects are of no less importance, and would have to be included in any general assessment. In this paragraph we must confine ourselves solely to its attempt to raise working-class standards. The experiment proved that a general increase in money wages, whether brought about by trade union action or by legislation securing shorter hours and holidays

with pay, does not necessarily improve the position of the whole working class. In the sense that the big industrialists, against whom these measures were directed, emerged better off than before, the experiment was a failure. Its net results were to improve the position of manual workers at the expense of the non-manual and the retired, to provoke an immediate increase of unemployment, and by reducing hours of work, to reduce the output of French industry. Much more might have been achieved by reforming the system of taxation so as to relieve the poorer classes of some of its burden, and by measures for destroying some of the big industrial monopolies, and bringing about a redistribution of property. As it happened, little was done on these lines, and the rapid rise of the cost of living served merely to discourage the workers by eating up the wage increases they had won. If, however, the experiment stimulates a re-thinking of labour strategy, it will not wholly have been in vain.

#### SUGGESTIONS FOR FURTHER READING

Einzig: *France's Crisis* deals with the period up to 1934, and Peel: *The Economic Policy of France* with the period from the end of the War to the end of the Blum experiment. For a detailed study of the effects of the Blum experiment one must consult two articles; Marjolin: "Reflections on the Blum Experiment," published in *Economica*, 1938, and Kalecki: "Lessons of the Blum Experiment," published in the *Economic Journal*, 1938.

## CHAPTER VIII

# THE UNITED STATES OF AMERICA

### HISTORICAL BACKGROUND

THE period 1925-9 was one of great confidence and prosperity in the United States. Production and employment reached hitherto untouched levels; income per head was greater than anywhere else in the world; and men felt certain that poverty was shortly to disappear, if it had not done so already. Then abruptly at the end of 1929 everything seemed to collapse. For the next three years prices fell steadily, unemployment climbed to the level of 14 million, and an atmosphere of heavy despair seemed to choke the whole economy.

We have already, in Chapter IV, analysed the causes of the boom and depression. We saw that the boom was due to no little extent to the opportunities for housing construction, the development of the automobile industry, factory construction and the reorganization of European industry. We also followed the course of the slump, and saw how it was prolonged by the collapse of banking systems in Europe and the shrinkage of international trade which followed the abandonment of the gold standard and of free trade.

One factor peculiar to the United States which helped to make it suffer so severely from the slump was the serious agricultural maladjustment which

had persisted for many years. It is not generally realized to how great an extent America is an agricultural country; but according to the 1930 census just over one-fifth of the population is engaged in agriculture, as compared with one-seventeenth in Britain; large parts of the continent have hardly yet been industrialized. Now one effect of the War of 1914-18 was that as men were drafted into the armies the output of agricultural products in Europe declined. This deficiency was made good by American agriculture, which expanded its output considerably. So soon as the War was over, however, the European countries set out to restore their output to its former level, and by 1925 they had succeeded. But as no parallel contraction occurred in America, overproduction developed in the sense that agricultural products were now very abundant relatively to other products, and fetched very low prices. From 1925 agricultural prices fell steadily, and the American farmer suffered a decline of income. His plight was worsened by the high tariff on manufactured goods. For, apart from the fact that this increased the price he had to pay for manufactured goods, foreign countries were less able to buy American agricultural products because America would not buy their manufactured goods, and they were forced to increase their agricultural production to the detriment of the American farmer because the American market was closed to their manufactured exports.

It has sometimes been suggested that the decline of farm purchasing power produced the slump of 1929. This in its crude form is a fallacy. Farmers had less money to spend because the rest of the population did not have to pay so much for agricultural



products. Consequently, though farmers were poorer the rest of the population was correspondingly richer, and had more money to spend on other things. Theoretically, the fact that they would not necessarily spend this money might produce disequilibrium, but in fact, as we have seen the period from 1925 to 1929 in which farm prices were declining was also one of great prosperity—farmers were poorer but the rest of the community was richer. The real contribution of agricultural maladjustment to the depression came after the slump had already occurred. The effect of the slump was to drive agricultural prices down still further. Now many banks had made loans to farmers on the security of their crops and lands, and as these fell in value and the farmers were unable to repay the loans, rural banks found themselves in difficulties. As they collapsed they pulled down many of the town banks which had lent them money, with the result that in the years 1930-2 5,299 banks failed in the United States. These failures reacted still further on business confidence, as people determined to hoard money rather than invest it, and did much to aggravate and prolong the depression. Finally the banking collapse reached its height in March 1933, just as President Roosevelt took office, when all the banks in the United States had to close their doors for a week.

We cannot enter here into every aspect of President Roosevelt's economic policy, but must concentrate attention on the more important measures. First and foremost come the efforts of the administration to promote recovery. Then we shall examine a short-lived attempt to "plan" American industry,

and a similar attempt to "plan" agriculture. And, finally, we shall discuss the labour policy of the régime.

#### FINANCIAL RECONSTRUCTION

To begin with unemployment. As the banking crisis coincided with the President's arrival at the White House, the first need was to restore confidence in the banks and the money of the country. The "banking holiday," which began on March 6th, 1933, lasted to March 10th. In the meantime, the Reconstruction Finance Corporation, created by President Hoover in 1932 agreed to make loans to those banks which were not too badly committed, and gradually more and more banks opened their doors. Later legislation provided for the insurance of bank deposits and for greater control by government agencies over banking policy. There is still much to be done before American banking will be as sound as banking in other countries, but the measures adopted were sufficient to restore confidence in the monetary system for the time being.

This, however, was not enough. Lack of confidence in the economic future was causing people to leave their money idle in the banks; in order to bring about revival and to increase employment it was necessary to get money to circulate freely once more. Hence the government adopted a number of measures designed to pump money into the economic system. The Reconstruction Finance Corporation had been working on these lines since its formation by Hoover in 1932, but on a comparatively small scale. Under Roosevelt it set about

pumping money into the system on a grand scale, both directly and through numerous intermediaries. Where did the money come from? Leaving out the technical details, what it boiled down to was that the government gave the public cheques drawn on the banks; thus the public's accounts at the banks were increased and they had more money to spend, while the banks held the government responsible for the new money created in this way. In this and other ways the government's debt has increased since 1933 by nearly £3,000,000,000.

A good part of this money was lent directly by the R.F.C. to banks and business houses. Some of it was lent through subsidiary organizations to persons thought to be overburdened with debt, such as persons whose houses were mortgaged and farmers whose land was mortgaged. Here there were several aims; the government was pumping money into circulation, but it was also helping people whom it thought to be deserving, and by preventing foreclosures was restoring confidence. Apart from the R.F.C. and its subsidiaries, funds were also poured out through other government agencies; through the Agricultural Adjustment Administration, in payment to farmers for agreeing to restrict production; through other bodies specially established to provide cheap credit facilities for farmers; through housing agencies; through various agencies for public works; and through others for relief of the unemployed, and as a bonus to ex-soldiers in 1936. The list of new government bodies set up by President Roosevelt to dispense public money is a lengthy one.

Much attention was focussed on the public

works programme. When Roosevelt came to power there were something like 14,000,000 in receipt of very inadequate relief through a multitude of governmental and private agencies. Under his administration the payment of relief has been reorganized on a federal basis. In addition a federal body is responsible for setting people to work on public projects—road building, drainage, engineering, and so on—and even writers, musicians, actors and other professional workers are being found work in their own line. Finally, to keep young men off the dole, the Civilian Conservation Corps was established, setting young men to work in labour camps on soil conservation, afforestation, land reclamation, and other work connected with the maintenance of the land.

Unfortunately, even this vast expenditure has not had the results which were expected of it. The downward movement of prices and production has stopped, and there has certainly been some recovery, but it has not been as great even as in Great Britain, where no such comparable sums have been spent. A large proportion of the money poured into the system is simply being held idle on the banks because the public will not invest it and put it into circulation. Part of the reason for this is that full recovery can only come about when the public feels confident enough once more to start spending its money on constructional work—new houses, electric power stations, new factories, and so on, and as yet such confidence has not returned. Indeed, the continued growth of the public debt is now regarded with some alarm, as a factor undermining confidence, since the public is afraid that sooner or later it will necessitate very high taxation. Another

factor of some importance is the very high level of building costs, relative to other prices, which tends to retard recovery in the constructional industries, and is to some extent (but not entirely) due to the government's own public works programme. And, finally, many business men distrust the reforming zeal of the Roosevelt administration; its reform of the stock exchange, its support of the trade union movement, its threatened attack on monopoly, and its continually expressed determination to reform the economic system have made them reluctant to undertake commitments, not knowing what is going to happen next. Roosevelt is therefore in an unfortunate position, since his efforts to redistribute wealth and power, limited though they are, hinder recovery. In other countries he would be able to plunge boldly ahead, setting up government industries to take the place of the reluctant business men, and thus achieving both his aims simultaneously; but in the United States the constitution limits strictly the power of the Federal government to intervene in industry. Hence he has to make up his mind whether to capitulate to "big business," in the interest of recovery, or to continue with his reforms. Fortunately, this impasse cannot long continue; in the past nine years much constructional work has accumulated, and sooner or later the nation will get down to it.

#### RECOVERY EXPERIMENTS

Pouring money into the economic system was not the only policy tried by the Roosevelt administration in order to promote recovery. One idea which

appealed to the government was that prices and wages should be raised as a means of promoting recovery. Now if everybody believes that a general increase in prices will promote recovery, such an increase, by stimulating confidence, may have some effect in releasing hoarded money. But apart from this, if all prices and wages rise in the same proportion, nobody is any better off, and there is no incentive to recovery. This lesson was soon learnt. Under the "National Recovery Act" of 1933 each industry was allowed to set up a committee to draw up a code for regulating the industry, and the general effect of the codes was to fix prices at higher levels. The right of collective bargaining between employer and employed was also laid down, and a number of the codes fixed minimum wages so high as to raise the general level of wages. In addition, the "Agricultural Adjustment Act" of 1933 set out to raise agricultural prices, partly by destroying crops, and partly by paying farmers to restrict their output. As prices and wages rose together there seems to have been little stimulus to recovery. If anything, these measures retarded recovery; building wages and costs rose disproportionately at a time when low prices were necessary in order to stimulate construction; and the disproportionate rise in agricultural prices diverted money from the urban population to the farmers who were more likely to hoard it.

A more successful measure was the "work sharing" campaign. Hours of work were reduced, so that the available work might be shared out among more people, and it is estimated that by reducing the working week to about thirty-five

hours, two million more persons were brought into employment. This cannot, however, be regarded as a real step towards recovery, since the real amount of work done and the level of production were unaffected. What is really needed is an increase of output.

Finally, various measures were taken affecting the international position of America. The tariff had long been fairly high; the notorious "Hawley-Smoot" tariff imposed in 1930 reached prohibitive levels. It was hoped that this tariff would increase employment, but the result was probably the reverse as the tariff played no little part in bringing about the collapse of many European countries, which did so much to prolong the slump. When President Roosevelt came to power he decided to abandon the Gold Standard and allow the dollar to fluctuate, and this led to a further curtailment of international trade. At last, in 1936, it was realized that no country was gaining from this economic warfare. Britain, America and France entered into a "tripartite" agreement to keep the rates of exchange between their currencies more or less stable, thus returning to the principles which the Gold Standard had sought to promote. And, finally, Roosevelt signed a number of trade agreements reducing the American tariff, of which not the least notable is the Anglo-American agreement of 1939, reducing tariffs on both sides of the Atlantic. The recovery of international trade is bound to play its part in general recovery.



## THE N.R.A.

Now let us turn to the experiment in planning industry. It arose partly from the belief that the slump was caused by the fall of prices (instead of seeing the fall of prices merely as a symptom of the onset of the slump), and that the fall of prices was due to excessive competition and over-production. Accordingly, in June 1933, the government passed the "National Recovery Act" to provide machinery for regulating production. Each industry was to set up a committee to draw up a "code" establishing, *inter alia*, maximum hours of labour, a minimum wage, and the conditions of production and sale. In practice the committees set to work to fix maximum prices and eliminate competition. We need not enter into all the difficulties which arose when they tried to decide what the price should be, how much could be sold at that price, and what share of the market each firm in the industry should have; nor need we investigate the confusion which was caused by the fact that while each committee was trying to do the best for itself, there was no central authority to see that their decisions should be consistent with each other. Had the scheme lasted any length of time, the government would have been forced to draw up a plan of its own, and to set up a department like "Gosplan" in Russia to subordinate the decisions of all these separate committees to the general plan.

What alarmed the public most were the effects of the law on the growth of monopoly. Ever since the end of the nineteenth century, when the growth of monopoly first attracted attention, American public



opinion has been strongly "anti-trust." In response to public feeling, railways and other public utilities were soon subjected to control. In addition, the Sherman Act of 1890 and the Clayton Act of 1914 prohibited certain practices likely to promote the growth of monopoly, and in 1914 a special body called the "Federal Trade Commission" was set up to prosecute persons breaking these "anti-trust" laws. Unfortunately, the laws were drafted very loosely, and as the courts have been rather prejudiced against them, have not been as fruitful as had been hoped, though the fear of prosecution has undoubtedly done something to restrain the growth of monopoly.

All this work seemed to be undone by the National Recovery Act. By the autumn of 1934 there were more than 500 committees at work making "codes," which fixed high prices and eliminated competition in exactly the same way as the executive committee of any monopolistic combination would have done. For all practical purposes the Act had repealed the anti-trust laws, and deliberately created hundreds of new monopolies. Public criticism of the measure grew steadily, and when in 1935 the Supreme Court declared that the act was invalid because the Constitution does not permit the government to pass laws of this kind, even the administration is believed to have heaved a sigh of relief. The whole experiment thus collapsed.

The enactment of the N.R.A. was all the more amazing because the President is well known to be opposed to monopoly. He came to power strongly opposed to the big electricity concerns whose

practices are very unpopular with the consumer. The "Tennessee Valley Authority" which he set up has as its principal legal justification the control of the waters of the Tennessee River, which is subject to severe flooding in the rainy season; but the main object in the President's mind is to use the river to generate electricity, partly to develop the surrounding area, and partly to have a "yardstick" by which to regulate the charges of private electricity concerns. He has also appointed a committee to investigate the growth of monopoly in the United States, and its report may lead to a strengthening of the anti-trust legislation. As we have already seen, this war on monopoly is believed to be one of the factors which has held up recovery, as it has caused "big business" to distrust the President, and to refrain from investing until there is more certainty as to what he intends to do.

#### THE A.A.A.

Side by side with N.R.A. went A.A.A., the "Agricultural Adjustment Act" designed to "plan" agriculture. We have already seen how American agriculture had been experiencing a depression ever since 1925. In 1929 a previous President had created a "Federal Farm Relief Board" to finance farmers so that they could keep agricultural products off the market in the hope of raising their prices. The Board had acquired control over large stocks of wheat and cotton, but had not solved the problem since the over-expansion of agriculture remained.

President Roosevelt adopted a more drastic solution. The Agricultural Adjustment Act of 1933

permitted the government to make contracts with farmers, paying the farmer an annual sum to reduce the acreage cultivated, and this policy was so successful that the droughts of 1934 and 1935 found the country producing insufficient foodstuffs for its own requirements. Eventually, this Act too was declared unconstitutional, but new legal loopholes were discovered which enable its substance to be continued.

The world was horrified by the deliberate destruction of growing crops and of livestock which A.A.A. entailed, at a time when millions were unemployed and in dire need. Since the real reason why farmers were depressed relatively to other sections of the population was that there were relatively too many farmers, the most useful policy would have been to encourage some farmers to turn to other occupations, by subsidizing the establishment of new industries. The "surplus" agricultural population should have been treated like the unemployed industrial population—set to work on useful projects and eventually absorbed into industry by an unemployment policy designed to promote recovery. To pay them to be idle, to destroy crops, and to leave land idle solved their immediate problem, but diminished the national welfare instead of increasing it.

#### LABOUR POLICY

Finally we come to the government's labour policy. A law of 1938 provides for minimum wages for industrial workers rising from 25 cents an hour in the first year to 40 cents in 1945 and thereafter. Hours of labour are fixed at a maximum of 44 per

week in the first year, diminishing to 40 in 1941 and thereafter. This law is the culmination of a series of measures, beginning in 1933, raising wages and reducing hours. So many other factors have been at work at the same time that it is not as easy in this case, as it was in the French case, to separate the exact effect of this legislation, but all the indications are that it has largely been offset by the resultant increase of prices.

Organized labour has not been neglected by the "New Deal" administration. The trade union movement has a fairly long history, but even to-day only includes a small proportion of the total number of employees. President Roosevelt has done his best to encourage it, and has passed legislation which gives workers in each establishment the right to organize and bargain collectively with their employers. There has been a bitter struggle to eliminate the "company unions," i.e. unions organized by employers for their workers as a counter-attraction to the independent trade union movement, and the new laws throw all the weight of the government against them. The trade union movement itself is split into two sections, the American Federation of Labour, which includes unions organized according to craft without reference to the industry in which the worker is employed, and the Committee for Industrial Organization, including unions each of which caters for all the workers in its particular industry whatever may be their craft. Efforts are being made to unite these two sections, and should they succeed, trade union organization will proceed even more rapidly.

Labour has also been affected by a new network

of social services. Before the slump the American worker received probably the highest wages in the world, but no one compelled him to insure himself against unemployment, sickness or old age. In consequence, most workers neglected to insure themselves in these ways, and when the slump came many millions found themselves in very low straits. The Social Security Act, which came into force in 1937, put an end to this. Henceforward workers will have to insure themselves in state schemes against various contingencies, including unemployment and sickness. The relief of unemployment has also been organized by the Federal government; as many unemployed as possible are put on to public works projects, or in the case of the younger workers, employed by the Civilian Conservation Corps, while the rest receive regular relief in cash and in kind.

#### CONCLUSION

What are we to conclude from these vast experiments on the American continent? Nowhere else has there been such popular enthusiasm behind a government as President Roosevelt enjoyed when he arrived at the White House, and yet, in no other country which we have examined has there been so little progress towards recovery. Economic ills, like other maladies, are not cured solely by good intentions; nor is it the most spectacular remedy, or the one which seems to get to the point most quickly, that is most likely to prove successful. Much of President Roosevelt's economic policy has been like the work of a man who thinks that the

most obvious treatment for a patient suffering from high fever is to put him into the refrigerator. N.R.A., A.A.A., the reduction of hours, the attempt to raise prices and wages—most of his work has been attacking the symptoms of maladjustment, rather than its fundamental causes, and it is not surprising that well-meant and spectacular as these measures have been, they have not contributed much towards solving the real problems. The principal value of such experiments is that we can learn from them what to avoid, and thereby arm our good intentions with sound policies. If the study of this and other experiments recounted in this book has helped any reader to see more clearly how our problems should be tackled, we shall not have travelled together in vain.

#### SUGGESTIONS FOR FURTHER READING

Baster: *Twilight of American Capitalism*, and Bailey: *Roosevelt and his New Deal*, are general surveys of the economic policy of the Roosevelt administration. On unemployment consult Brookings Institution: *The Recovery Problem in America*; on the N.R.A., Roos: *N.R.A. Economic Planning*; and on monopoly Jenks and Clark: *The Trust Problem*.

# QUESTIONS FOR DISCUSSION

## CHAPTER I

1. What are the advantages and disadvantages of specialization? Are the disadvantages insuperable?
2. Compare the relative merits of the three following methods of deciding to what purposes the community's resources should be put:  
(a) A plan drawn up by workers in factories and other establishments;  
(b) Elections; (c) A system of markets.
3. To what extent should the state decide how the individual's income should be spent?
4. Discuss the case for and against supplying free social services to the poor instead of making direct payments to them in cash.
5. "To each according to his need, and from each according to his ability." If you were Prime Minister in a socialist government, what considerations would you have in mind in deciding how far to run the economic system on this basis?
6. Discuss the case for and against the prohibition of monopolistic associations.
7. The demand for a certain commodity diminishes, and its producers apply to the government for assistance. What types of assistance can the government give, and what considerations are relevant in deciding how it should reply?
8. Should there be a minimum wage enforced on all employers? Discuss this question in the light of the alternative methods of assisting people with low incomes.
9. Explain the methods by which a government secures the resources necessary for prosecuting a war.
10. What is meant by "casting the burden of the war on to future generations"?
11. Compare the merits of the alternative methods of financing a war.

## CHAPTER II

1. What are the advantages and disadvantages of maintaining a small class in inherited luxury?
2. A trade union succeeds in raising the wages of one grade of labour by negotiation. In what circumstances would this gain be at the expense of (a) other workers, (b) property owners, (c) nobody?

3. In what way could inheritance taxes be used to secure a more equal distribution of property?

4. To what extent are the economic problems of an equalitarian socialist society similar to those of a society where private property is equally distributed, and to what extent are they different?

### CHAPTER III

1. What purposes did the Gold Standard seek to serve, and why did it break down?

2. What is the case for and against an attempt to attain self-sufficiency?

3. A tariff is imposed on the importation of foreign steel. Three years later a newspaper publishes an article arguing that because the domestic output of steel has trebled and unemployment in the steel industry diminished, the imposition of the tariff is proved to have been in the national interest. Write a suitable commentary.

4. "If we allow foreigners with low standards of living to send us their goods, they will reduce our standards to their own level. Tariffs should be imposed on the goods of all countries whose prices are lower than our own." Comment.

5. Should the admission of immigrants be restricted? Distinguish the economic and the other factors involved.

6. The people of Wales secede from the United Kingdom, make war on England, and defeat her. In what ways can they benefit from their conquest?

7. Discuss the arguments for and against the establishment of a federal government in Europe, with powers similar to those of the federal government of the United States of America.

### CHAPTER IV

1. What are employment exchanges? How do they reduce unemployment?

2. What is the origin of the depressed areas in Great Britain?

3. Outline and compare the methods by which unemployment in the depressed areas might be reduced.

4. Discuss the arguments for and against state regulation of the location of industry.

5. "The public should learn to spend freely, for saving takes money out of circulation and causes unemployment." Discuss this statement.

6. Enumerate the factors which produced the boom of the late twenties.



## QUESTIONS

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7. Why was the slump which began in 1929 of such prolonged duration?
8. "A general increase in wages would promote recovery by giving workers more purchasing power." "Lower wages would enable employers to take on more workers and thus reduce unemployment." Discuss these claims.
9. What measures can governments take to reduce the intensity of the trade cycle?

## CHAPTER V

1. Write an account of the origins of the Revolutions of 1917.
2. Discuss the advantages and disadvantages of "Workers' Control."
3. Discuss the difficulties inherent in central planning. How far is central planning essential to socialism?
4. Write an account of the first five-year plan.
5. In what ways does central planning reduce the likelihood of unemployment emerging?
6. On what incentives does the Russian Government rely to secure efficiency?
7. Discuss the position of the trade union movement in Russia.
8. Write an account of the position of the peasant since 1917.
9. What are the principal achievements of the Communist government, and what its principal faults? How far have the latter been necessary in order that the former might be realized?

## CHAPTER VI

1. What is meant by inflation? Illustrate some of its effects from German experience.
2. Account for the high level of unemployment in Germany in 1932.
3. Give a critical survey of the policies adopted by the Nazi régime to deal with unemployment.
4. Write an outline of Nazi labour policy.
5. What are the distinguishing features of a war economy? How many of these features were present in Germany at the end of 1938?

## CHAPTER VII

1. Explain the fall in the value of the franc between 1919 and 1926.
2. Set out the points involved in the 1931-6 controversy over the proposal to devalue the franc.

3. Give an account of the wage and hours legislation of the Blum government. What were its effects?
4. Evaluate the agricultural policy of the Blum government.
5. Account for the increase of unemployment after 1931 and explain why there was practically no unemployment in the latter half of 1937.

## CHAPTER VIII

1. Why did unemployment reach so high a level in America in 1933?
2. Give an account of the measures by which the Roosevelt administration has sought to promote recovery. Why is there still so much unemployment?
3. Write critical accounts of (i) N.R.A. and (ii) A.A.A.
4. In what ways has the American government sought to control monopoly?
5. Outline the labour policy of the Roosevelt administration.

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